

REVENUE DEPARTMENT[701]

Regulatory Analysis

Notice of Intended Action to be published: 701—Chapters 302 and 303
“Determination of Net Income; Iowa-Source Income”

Iowa Code section(s) or chapter(s) authorizing rulemaking: 421.14, 422.7, and 422.8

State or federal law(s) implemented by the rulemaking: Iowa Code sections 99G.31, 422.5, 422.7, and 422.8

Public Hearing

A public hearing at which persons may present their views orally or in writing will be held as follows:

November 18, 2026
9 to 10 a.m.

Via videoconference call:
meet.google.com/sbm-ihix-ere

Public Comment

Any interested person may submit written or oral comments concerning this Regulatory Analysis, which must be received by the Department of Revenue no later than 4:30 p.m. on the date of the public hearing. Comments should be directed to:

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Purpose and Summary

The proposed rulemaking rescinds Chapters 302 and 303 and replaces them with a new Chapter 302 that describes how to calculate net income for individual taxpayers and a new Chapter 303 that describes how income is sourced to Iowa for individual income tax purposes. This rulemaking will remove outdated language that relates to adjustments that are no longer required by Iowa law and language that is redundant to statute as required by Executive Order 10. This rulemaking will also remove rules related to the sourcing of Iowa net income from the present Chapter 302 and move that content to Chapter 303. Citations in the proposed rules to Iowa Code chapter 12L are to that chapter as enacted by 2026 Iowa Acts, Senate File 2472.

Analysis of Impact

1. Persons affected by the proposed rulemaking:

- **Classes of persons that will bear the costs of the proposed rulemaking:**

There are no costs associated with the proposed rulemaking beyond that of the statutes it implements.

- **Classes of persons that will benefit from the proposed rulemaking:**

Taxpayers, nonresidents of Iowa, part-year residents of Iowa, tax practitioners, and the Department will benefit from the proposed rulemaking.

2. Impact of the proposed rulemaking, economic or otherwise, including the nature and amount of all the different kinds of costs that would be incurred:

- **Quantitative description of impact:**

There are no costs associated with the proposed rulemaking beyond that of the requirements in the statutes it implements.

- **Qualitative description of impact:**

The rulemaking provides guidance to individual taxpayers on how to calculate their Iowa net income and how to determine what portion of their income is subject to Iowa individual income tax.

3. Costs to the State:

- **Implementation and enforcement costs borne by the agency or any other agency:**

The rulemaking is implementing requirements in statute and does not have any additional cost to the agency beyond any associated with the statutory requirements.

- **Anticipated effect on State revenues:**

The rulemaking shall have no effect on State revenues because the requirements are already included in law. The guidance may reduce costs for the State in compliance and enforcement costs.

4. Comparison of the costs and benefits of the proposed rulemaking to the costs and benefits of inaction:

The proposed rulemaking provides guidance to taxpayers on how to calculate their Iowa taxable income and how their income is sourced to Iowa. Without this guidance, taxpayers could have increased costs in seeking guidance or incorrectly reporting their Iowa net income.

5. Determination whether less costly methods or less intrusive methods exist for achieving the purpose of the proposed rulemaking:

There are no known less costly or less intrusive methods.

6. Alternative methods considered by the agency:

- **Description of any alternative methods that were seriously considered by the agency:**

The only alternatives are no guidance or informal guidance.

- **Reasons why alternative methods were rejected in favor of the proposed rulemaking:**

No guidance or informal guidance given on a case-by-case basis would be less helpful to taxpayers, tax practitioners, and the Department. There could be increased costs to taxpayers to request guidance and informal guidance could be inconsistent over time.

Small Business Impact

If the rulemaking will have a substantial impact on small business, include a discussion of whether it would be feasible and practicable to do any of the following to reduce the impact of the rulemaking on small business:

- Establish less stringent compliance or reporting requirements in the rulemaking for small business.

- Establish less stringent schedules or deadlines in the rulemaking for compliance or reporting requirements for small business.

- Consolidate or simplify the rulemaking's compliance or reporting requirements for small business.

- Establish performance standards to replace design or operational standards in the rulemaking for small business.

- Exempt small business from any or all requirements of the rulemaking.

If legal and feasible, how does the rulemaking use a method discussed above to reduce the substantial impact on small business?

The requirements in this proposed rulemaking are imposed by statute, and the Department does not have the authority to make exceptions to them for small businesses.

Text of Proposed Rulemaking

ITEM 1. Rescind 701—Chapter 302 and adopt the following **new** chapter in lieu thereof:

CHAPTER 302
DETERMINATION OF NET INCOME

701—302.1(422) Net income defined. Net income for state individual income tax purposes means federal taxable income as properly computed under the Internal Revenue Code (IRC) and shall include the adjustments in Iowa Code section 422.7.

This rule is intended to implement Iowa Code section 422.7.

701—302.2(422) Interest and dividends from federal securities. For individual income tax purposes, the state is prohibited by federal law from taxing dividends from corporations owned or sponsored by the federal government or interest derived from obligations of the United States and its possessions, agencies, and instrumentalities. Additionally, stocks and obligations of the United States government are exempt from state income taxation. Therefore, if the federal taxable income of an individual includes dividends or interest of this type, the amount of the dividend or interest must be deducted from the Iowa net income. Also, preemptive federal law may preclude state taxation of interest income from the securities of federal government-sponsored enterprises and agencies and from the obligations of U.S. territories. Any profit or gain on the sale or exchange of these securities is taxable.

302.2(1) Definition. For purposes of this chapter:

“*Obligations of the United States*” means those obligations issued to secure credit to carry on the necessary functions of government. A governmental obligation that is secondary, indirect, or contingent, such as a guaranty of a nongovernmental obligor’s primary obligation to pay the principal amount of and interest on a note, is not an obligation of the United States.

302.2(2) The following is a nonexhaustive list of widely held obligations of the United States.

a. Obligations of the United States: United States Treasury—Principal and interest from bills, bonds, and notes issued by the United States Treasury exempt under 31 U.S.C. §3124(a).

- (1) Series E, F, G, H, and I bonds.
- (2) United States Treasury bills.
- (3) U.S. Government certificates.
- (4) U.S. Government bonds.
- (5) U.S. Government notes.
- (6) Original issue discount (OID) on a United States Treasury obligation.

b. Territorial obligations:

(1) Guam—Principal and interest from bonds issued by the Government of Guam (48 U.S.C. §1423a).

(2) Puerto Rico—Principal and interest from bonds issued by the Government of Puerto Rico (48 U.S.C. §745).

(3) Virgin Islands—Principal and interest from bonds issued by the Government of the Virgin Islands (48 U.S.C. §1403).

(4) Northern Mariana Islands—Principal and interest from bonds issued by the Government of the Northern Mariana Islands (PL 94-241, §607, 90 Stat. 263 (1976)).

c. Federal agency obligations:

(1) Commodity Credit Corporation—Principal and interest from bonds, notes, debentures, and other similar obligations issued by the Commodity Credit Corporation (15 U.S.C. §713a-5).

(2) Banks for Cooperatives—Principal and interest from notes, debentures, and other obligations issued by Banks for Cooperatives (12 U.S.C. §2134).

(3) Farm Credit Banks—Principal and interest from systemwide bonds, notes, debentures, and other obligations issued jointly and severally by Banks of the Federal Farm Credit System (12 U.S.C. §2023).

(4) Federal Land Bank Association—Principal and interest from bonds, notes, debentures, and other obligations issued by the Federal Land Bank Association (12 U.S.C. §2098).

(5) Production Credit Association—Principal and interest from notes, debentures, and other obligations issued by Production Credit Association (12 U.S.C. §2077).

(6) Federal Deposit Insurance Corporation (FDIC)—Principal and interest from notes, bonds, debentures, and other such obligations issued by the FDIC (12 U.S.C. §1825).

(7) Federal Financing Bank—Interest from obligations issued by the Federal Financing Bank. Considered to be United States Government obligations (12 U.S.C. §2290, 31 U.S.C. §3124(a)).

(8) Federal Home Loan Bank—Principal and interest from notes, bonds, debentures, and other such obligations issued by any Federal Home Loan Bank and consolidated Federal Home Loan Bank bonds and debentures (12 U.S.C. §1433).

(9) Financing Corporation (FICO)—Principal and interest from any obligation of the Financing Corporation (12 U.S.C. §1441(e)(7) and §1433).

(10) General Services Administration (GSA)—Principal and interest from General Services Administration participation certificates (considered to be United States Government obligations) (31 U.S.C. §3124(a)).

(11) Housing and Urban Development (HUD).

1. Principal and interest from War Housing Insurance debentures (12 U.S.C. §1739(d)).

2. Principal and interest from Rental Housing Insurance debentures (12 U.S.C. §1747g(g)).

3. Principal and interest from Armed Services Mortgage Insurance debentures (12 U.S.C. §1748b(f)).

4. Principal and interest from National Defense Housing Insurance debentures (12 U.S.C. §1750c(d)).

5. Principal and interest from Mutual Mortgage Insurance Fund debentures (12 U.S.C. §1710(d)).

(12) National Credit Union Administration Central Liquidity Facility—Income from notes, bonds, debentures, and other obligations issued on behalf of the National Credit Union Administration Central Liquidity Facility (12 U.S.C. §1795k(b)).

(13) Resolution Funding Corporation—Principal and interest from obligations issued by the Resolution Funding Corporation (12 U.S.C. §1441b(f)(7) and §1433).

(14) Student Loan Marketing Association (Sallie Mae)—Principal and interest from obligations issued by the Student Loan Marketing Association. Considered to be United States Government obligations (20 U.S.C. §1087-2, 31 U.S.C. §3124(a)).

(15) Tennessee Valley Authority—Principal and interest from bonds issued by the Tennessee Valley Authority (16 U.S.C. §831n-4(d)).

(16) United States Postal Service—Principal and interest from obligations issued by the United States Postal Service (39 U.S.C. §2005(d)(4)).

(17) Treasury Investment Growth Receipts.

(18) Certificates on Government Receipts.

302.2(3) Taxable securities. There are a number of securities issued under the authority of an Act of Congress that are subject to Iowa individual income tax. Examples of securities that fall into this category are those issued by the following agencies and institutions:

a. Federal agency obligations:

(1) Federal or State Savings and Loan Associations.

(2) Export-Import Bank of the United States.

(3) Building and Loan Associations.

- (4) Interest on federal income tax refunds.
- (5) Postal Savings Account.
- (6) Farmers Home Administration.
- (7) Small Business Administration.
- (8) Federal or State Credit Unions.
- (9) Mortgage Participation Certificates.
- (10) Federal National Mortgage Association.
- (11) Federal Home Loan Mortgage Corporation (Freddie Mac).
- (12) Federal Housing Administration.
- (13) Federal National Mortgage Association (Fannie Mae).
- (14) Government National Mortgage Association (Ginnie Mae).
- (15) Merchant Marine (Maritime Administration).
- (16) Federal Agricultural Mortgage Corporation (Farmer Mac).
- b. Obligations of international institutions:
 - (1) Asian Development Bank.
 - (2) Inter-American Development Bank.
 - (3) International Bank for Reconstruction and Development (World Bank).
- c. Other obligations:
 - (1) Washington, D.C., Metro Area Transit Authority.
 - (2) Interest from repurchase agreements involving federal securities Interest from Mortgage Backed Certificate Guaranteed by Ginnie Maes.

Rule 701—302.3(422) provides information for the treatment of interest or dividends from regulated investment companies (mutual funds) that invest in obligations of the type discussed in this rule.

This rule is intended to implement Iowa Code section 422.7.

701—302.3(422) Mutual funds.

302.3(1) Iowa does not tax dividend or interest income from regulated investment companies to the extent that such income is derived from interest on obligations of the United States Government or obligations of this state and its political subdivisions. The exemption is also applicable to income from regulated investment companies that is derived from interest on government-sponsored enterprises and agencies where federal law specifically precludes state taxation of such interest. Income derived from interest on securities that are merely guaranteed by the federal government or from repurchase agreements collateralized by the United States Government obligations is not excluded and is subject to Iowa income tax. There is no distinction between the treatment of interest received by a direct investor as compared with a mutual fund shareholder. The interest retains its same character when it flows through the mutual fund and is subject to taxation accordingly.

302.3(2) Taxpayers may subtract from net income any income received from any of the obligations listed in subrule 302.2(1) and Iowa Code section 422.7(2), even if the obligations are owned indirectly through owning shares in a mutual fund:

- a. If the fund invests exclusively in these state tax-exempt obligations, the entire amount of the distribution (income) from the fund may be subtracted.
- b. If the fund invests in both exempt and nonexempt obligations, the amount represented by the percentage of the distribution that the mutual fund identifies as exempt may be subtracted.
- c. If the mutual fund does not identify an exempt amount or percentage, taxpayers may figure the amount to be subtracted by multiplying the distribution by the following fraction: as the numerator, the amount invested by the fund in state-exempt United States obligations; as the denominator, the fund's total investment. If the percentage ratio has remained constant throughout the year, the year-end amounts are used to figure the fraction. If the percentage ratio has not remained constant, the average of the ratios from the fund's quarterly financial reports is used.

This rule is intended to implement Iowa Code section 422.7.

701—302.4(422) Additional deduction for wages paid or accrued for work done in Iowa by certain individuals. A taxpayer who operates a business that is considered to be a small business as defined in Iowa Code section 422.7(6) “c”(2) is allowed an additional deduction of 65 percent of the first 12 months of wages paid or accrued during the tax year for work done in Iowa by certain employees first hired during the accounting period ending with or during the tax year. The employee must meet the criteria in Iowa Code section 422.7(6) “a”(1), “a”(2), or “a”(3).

302.4(1) Definitions.

“*Annual gross revenues*” means total sales, before deducting returns and allowances but after deducting corrections and trade discounts, sales taxes and excise taxes based on sales, as determined in accordance with generally accepted accounting principles.

“*Has a record of such impairment*” means has a history of, or has been misclassified as having, a mental or physical impairment that substantially limits one or more major life activities.

“*Individual with a disability*” means any person who has a physical or mental impairment that substantially limits one or more major life activities, has a record of such impairment, or is regarded as having such an impairment. “Individual with a disability” does not include any person whose current use of alcohol or controlled substances prevents the person from performing the duties of employment or whose employment, by reason of current use of alcohol or controlled substances, would constitute a direct threat to the property or the safety of others.

“*Is regarded as having such an impairment*” means:

1. Has a physical or mental impairment that does not substantially limit major life activities but that is perceived as constituting such a limitation;
2. Has a physical or mental impairment that substantially limits major life activities only as a result of the attitudes of others toward such impairment; or
3. Has none of the impairments defined as physical or mental impairments but is perceived as having such an impairment.

“*Major life activities*” means functions such as caring for one’s self, performing manual tasks, walking, seeing, hearing, speaking, breathing, learning, and working.

“*Physical or mental impairment*” means:

1. Any physiological disorder or condition, cosmetic disfigurement, or anatomical loss affecting one or more of the following body systems: neurological; musculoskeletal; special sense organs; respiratory, including speech organs; cardiovascular; reproductive; digestive; genitourinary; hemic and lymphatic; and skin and endocrine, or
2. Any mental or psychological disorder, such as intellectual disability, organic brain syndrome, emotional or mental illness, and specific learning disabilities.

“*Probationary period*” means the period of probation for newly hired employees if the employer has a written probationary policy. If the employer has no written probationary policy for newly hired employees, the probationary period shall be considered to be six months from the date of hire.

“*Small business*” means a business entity organized for profit including but not limited to an individual proprietorship, partnership, joint venture, association or cooperative. “Small business” does not include the practice of a profession.

“*Successfully completing a probationary period*” includes those instances where the employee quits without good cause attributable to the employer during the probationary period or was discharged for misconduct during the probationary period.

“*The practice of a profession*” means vocation requiring specialized knowledge and preparation including but not limited to the following: medicine and surgery, podiatry, osteopathy, osteopathic medicine and surgery, psychology, psychiatry, chiropractic, nursing, dentistry, dental hygiene, optometry, speech pathology, audiology, pharmacy, physical therapy, occupational therapy, mortuary science, law, architecture, engineering and surveying, and accounting.

302.4(2) A taxpayer who operates a business that does not qualify as a small business as defined in Iowa Code section 422.7(6) “c”(2) may claim an additional deduction for wages paid or accrued for work done in Iowa by certain convicted felons as described in Iowa Code section 422.7(7) “a.” The

additional deduction is 65 percent not to exceed \$20,000 for the first 12 months of wages paid for work done in Iowa.

302.4(3) The following conditions apply to a business entity that is a small business for purposes of the additional deduction for wages:

a. The small business shall not have had more than 20 full-time equivalent employee positions during each of the 26 consecutive weeks within the 52-week period immediately preceding the date on which an individual for whom an additional deduction for wages is taken was hired. Full-time equivalent position means any of the following:

- (1) An employment position requiring an average work week of 40 or more hours;
- (2) An employment position for which compensation is paid on a salaried full-time basis without regard to hours worked; or
- (3) An aggregation of any number of part-time positions that equal one full-time position. For purposes of this subrule, each part-time position shall be categorized with regard to the average number of hours worked each week as a one-quarter, half, three-quarter, or full-time position, as set forth in the following table:

<u>Average Number of Weekly Hours</u>	<u>Category</u>
More than 0 but less than 15	¼
15 or more but less than 25	½
25 or more but less than 35	¾
35 or more	1 (full-time)

b. The small business cannot have more than \$3 million in annual gross revenues or as the average of the three preceding tax years.

c. The small business shall not be an affiliate or subsidiary of a business that is dominant in its field of operation.

302.4(4) If a newly hired employee has been certified as either a vocational rehabilitation referral or an economically disadvantaged ex-convict for purposes of qualification for the work opportunity tax credit under IRC Section 51, that employee shall be considered to have met the qualifications for the additional wage deduction.

a. A vocational rehabilitation referral is any individual certified by a state employment agency as having a physical or mental disability that, for the individual, constitutes or results in a substantial handicap to employment. In addition, the individual must have been referred to the employer after completion or while receiving rehabilitation services pursuant to either a state or federal approved vocational rehabilitation program.

b. For all other newly hired employees, the employer has the burden of proof to show that the employees meet the qualifications for the additional wage deduction.

302.4(5) The taxpayer shall include a schedule with the filing of its tax return showing the name, address, social security number, date of hiring and wages paid of each employee for which the taxpayer claims the additional deduction for wages.

302.4(6) If the employee for which an additional deduction for wages was allowed fails to successfully complete a probationary period and the taxpayer has already filed an Iowa individual income tax return taking the additional deduction for wages, the taxpayer shall file an amended return adding back the additional deduction for wages. The amended return shall state the name and social security number of the employee who failed to successfully complete a probationary period.

This rule is intended to implement Iowa Code section 422.7.

701—302.5(422) Disability income exclusion.

302.5(1) A taxpayer who is permanently and totally disabled and has not attained 65 years of age by the end of the tax year or reached mandatory retirement age can exclude from Iowa taxable income a maximum of \$100 per week of payments received in lieu of wages. In order for the payments to qualify for the exclusion, the payments must be made under a plan providing payment of such

amounts to an employee for a period during which the employee is absent from work on account of permanent and total disability.

302.5(2) In the case of a married couple where both spouses meet the qualifications for the disability exclusion, each spouse may exclude \$5,200 of income received on account of disability.

302.5(3) There is a reduction in the exclusion, dollar for dollar, to the extent that a taxpayer's federal adjusted gross income (determined without this exclusion and without the deduction for the two-earner married couple) exceeds \$15,000. In the case of a married couple, both spouses' incomes must be considered for purposes of determining if the disability income exclusion is to be reduced for income that exceeds \$15,000. The taxpayers' disability income exclusion is eliminated when the taxpayers' federal adjusted gross income is equal to or exceeds \$20,200.

EXAMPLE: A married couple is filing their Iowa return. Spouse A retired during the year and received \$8,000 in disability income during the 40-week period that year that he was retired. Spouse A's other income for the tax year was \$2,500, and Spouse B's income was \$7,500. Of the \$8,000 in disability payments, only \$4,000 is eligible for the exclusion. This is because the maximum amount that can be excluded on a weekly basis as a result of the disability exclusion is \$100.

However, the \$4,000 that qualifies for the exclusion must be reduced to the extent that Spouse A's federal adjusted gross income exceeds \$15,000. Spouse A's federal adjusted gross income is \$18,000, which exceeds \$15,000 by \$3,000. Therefore, the amount eligible for exclusion of \$4,000 must be reduced by \$3,000, resulting in an exclusion of \$1,000.

302.5(4) For purposes of the disability income exclusion, "permanent and total disability" means the individual is unable to engage in any substantial gainful activity by reason of a medically determinable physical or mental impairment that (1) can be expected to last for a continuous period of 12 months or more or (2) can be expected to result in death. A certificate from a qualified physician is required attesting to the taxpayer's permanent and total disability as of the date the individual claims to have retired on disability. The certificate must include the name and address of the physician and contain an acknowledgment that the certificate will be used by the taxpayer to claim the exclusion. In an instance where an individual has been certified as permanently and totally disabled by the Veterans Administration, Form 6004 may be used instead of the physician's certificate. Form 6004 must be signed by a physician on the VA disability rating board.

302.5(5) Mandatory retirement age is the age at which the taxpayer would have been required to retire under the employer's retirement program.

302.5(6) The disability income exclusion is not applicable to federal income tax for tax years beginning after 1983. However, the revenue rulings, court cases and other provisions that were relevant to the disability income exclusion for the tax periods when the exclusion was available on federal returns are applicable to the disability income exclusion for Iowa purposes.

This rule is intended to implement Iowa Code section 422.7.

701—302.6(422) Capital gain exclusion for elected employee-owned stock in a qualified corporation.

302.6(1) *In general.* Employee-owners may make a single, irrevocable lifetime election to exclude from net income the net capital gain from the sale or exchange of capital stock from a qualified corporation.

302.6(2) *Definitions.* Unless otherwise indicated in this rule or required by the context, all words and phrases used in this rule that are defined under Iowa Code section 422.7(42) shall have the same meaning as provided to them under that Iowa Code section.

302.6(3) *Qualifying for the exclusion.* For the employee-owner's sale or exchange to qualify for this exclusion, the capital stock must be acquired by the employee-owner while employed and on account of employment with a qualified corporation.

a. While employed. The capital stock must have been acquired while the employee-owner was employed by the qualifying corporation. Capital stock received as compensation is acquired by the employee-owner while employed. Capital stock acquired from a stock right, stock warrant, or stock

option is only acquired by the employee-owner while employed if such right, warrant, or option is exercised while the employee-owner is employed by the qualifying corporation.

b. On account of employment. For capital stock to have been acquired on account of employment, the employee-owner must have acquired the capital stock in a manner only available to employees of the qualified corporation. Capital stock acquired at formation in exchange for capital contribution is not acquired on account of employment.

c. Holding period. To qualify for the exclusion, the employee-owner must own the capital stock for at least ten cumulative years. If the employee-owner owns any capital stock in the qualified corporation for at least ten cumulative years, then every share of the employee-owner's capital stock in that qualified corporation is considered to meet the holding period requirement. For stock rights, stock warrants, or stock options, the holding period does not begin until the right, warrant, or option is exercised.

302.6(4) Electing capital stock for exclusion.

a. General. The employee-owner shall make the election to exclude capital gain from the sale of capital stock of a qualified corporation on a form prescribed by the department with the employee-owner's Iowa income tax return for the tax year in which the election is made. The form shall be available on the department's website. To qualify for the exclusion, the employee-owner must include all information required by the form.

b. Election when sale or exchange takes place over multiple transactions. The election applies to all subsequent sales or exchanges of capital stock of the same qualified corporation of which the initial election was made, within 15 years of the date the election was made. The employee-owner shall include the form prescribed by the department with the employee-owner's Iowa income tax return when claiming the exclusion for a subsequent sale or exchange.

c. Election can only be made once. An employee-owner may only make one lifetime election to exclude the qualifying capital stock of a single qualifying corporation under this rule. The election is irrevocable once made.

302.6(5) Election by a party other than the employee-owner.

a. Election upon death of the employee-owner. If the employee-owner dies after having sold or exchanged qualifying capital stock without having made an election, the surviving spouse or, if there is no surviving spouse, the personal representative of the employee-owner's estate may make a qualifying election in the manner described in subrule 302.6(4) for the tax year in which the employee-owner died.

b. Inter vivos transfer of qualifying capital stock. After the election described in this rule has been made, the election applies to capital stock transferred from the employee-owner to the employee-owner's spouse as an inter vivos gift or to an inter vivos trust primarily for the benefit of the employee-owner's spouse. Capital stock transferred through a will or testamentary trust does not qualify for this exclusion. The election only applies if the spouse was married to the employee-owner on the date of the sale or exchange or the date of death of the employee-owner.

This rule is intended to implement Iowa Code section 422.7.

701—302.7(422) Exclusion of pensions and other retirement benefits for disabled individuals, individuals who are 55 years of age or older, surviving spouses, and survivors. An individual who is disabled, is 55 years of age or older, is a surviving spouse, or is a survivor with an insurable interest in an individual who would have qualified for the exclusion at the time of death is eligible for an exclusion of retirement benefits received in the tax year. More information can be found in rule 701—302.12(422) for the exclusion of military retirement pay.

302.7(1) Retirement income.

a. Qualifying retirement income. Generally, distributions from documented retirement plans meeting the qualification requirements in the Internal Revenue Code qualify for the retirement income exclusion. The following is a nonexclusive list of plans that qualify for the retirement income exclusion:

- (1) Traditional individual retirement account (IRA) authorized under IRC Section 408(a).
- (2) Roth individual retirement account (Roth IRA) authorized under IRC Section 408A.
- (3) Roth conversion income.
- (4) Simplified employee pension individual retirement arrangement (SEP-IRA) defined in IRC Section 408(k).
- (5) Savings incentive match plan for employees (SIMPLE IRA) defined under IRC Section 408(p).
- (6) Qualified deferred compensation plans including those authorized under IRC Section 401(k).
- (7) Eligible deferred compensation plans including those authorized under IRC Section 457(b).
- (8) A defined benefit plan, pension plan, profit-sharing plan, or stock bonus plan qualified under IRC Section 401 including IPERS and employee stock ownership plans (ESOPs).
- (9) Keogh plans or HR 10 plans.
- (10) Eligible combined plans described in IRC Section 414(x).

b. Retirement income that does not qualify. Generally, distributions from retirement plans that do not meet the qualification requirements in the Internal Revenue Code do not qualify for the retirement income exclusion. The following nonexclusive list of plans does not qualify for the retirement income exclusion:

- (1) Nonqualified deferred compensation plans described in IRC Section 409A.
- (2) Nonqualified annuities.

302.7(2) *Survivors having an insurable interest.*

a. Insurable interest. “Insurable interest” is a term used in life insurance that also applies to this rule and means an interest in the life of the person insured arising from the relations of the party obtaining the insurance, either as credit of or surety for the insured, or from the ties of blood or marriage to the insured, as would justify a reasonable expectation of advantage or benefit from the continuance of the life of the insured. For purposes of this rule, “insurable interest” applies to a beneficiary receiving retirement benefits due to the death of a decedent under the same circumstances as if the beneficiary were receiving life insurance benefits as a result of the death of the decedent. Case law related to an insurable interest in the life insurance context is relevant in determining whether a beneficiary is a survivor with an insurable interest.

b. Survivors with an insurable interest must be natural persons. Only natural persons may be a survivor with an insurable interest for purposes of this exclusion.

c. Parties deemed to have an insurable interest by relationship. Some relationships are deemed so close that the individual will have an insurable interest in the decedent, including spouses in each other’s lives, parents in the lives of their children, and children in the lives of their parents.

d. Individuals other than close relations may be a survivor with an insurable interest. Individuals other than those with a relationship with the decedent described in paragraph 302.7(2) “c” must establish that they had a pecuniary interest in the continuation of the life of the decedent at the time of death to be considered a survivor with an insurable interest. The beneficiary has the burden of proof to show that the beneficiary had a reasonable expectation of an advantage or benefit that the beneficiary would have received with the continuance of the life of the decedent. Being named a beneficiary of the retirement plan alone does not establish that an individual is a survivor with an insurable interest.

EXAMPLE: A grandson was receiving college tuition regularly from his grandfather and received the grandfather’s pension as a beneficiary of the grandfather after the grandfather’s death. The grandson would be deemed to have an insurable interest in the benefits and would be eligible for the retirement income exclusion.

302.7(3) *Disabled individuals.* For purposes of this rule, a disabled individual is a person who is receiving benefits as a result of retirement from employment or self-employment due to disability. In addition, a person is considered to be a disabled individual if the individual is determined to be disabled in accordance with criteria established by the Social Security Administration or other federal or state governmental agency.

This rule is intended to implement Iowa Code sections 422.5 and 422.7.

701—302.8(422) Health insurance premiums deduction. A taxpayer who is 65 years of age or older and whose net income is less than \$100,000 may exclude from net income the amounts paid for health benefits coverage or insurance for the taxpayer, the taxpayer's spouse, and the taxpayer's dependents to the extent the amounts paid were not otherwise deductible in computing federal taxable income.

302.8(1) Qualifying expenses.

a. Health benefits coverage or health insurance payments that qualify for the federal medical expense deduction under IRC Section 213(d)(1)(D) qualify for this deduction.

b. Amounts paid by a taxpayer for health insurance on a pretax basis whereby the portion of the wages of the taxpayer used to pay health insurance premiums is not included in the taxpayer's gross wages for income tax or social security tax purposes are not deductible.

c. Amounts paid under an insurance contract for nonmedical care (e.g., payment for loss of limb, life or sight) are not deductible unless the medical charge is stated separately in the contract or provided in a separate statement.

302.8(2) Married taxpayers. In situations where married taxpayers pay health insurance premiums from a joint bank account and the taxpayers are filing separate returns, the taxpayers must allocate the deduction between the spouses on the basis of the net income of each spouse to the combined net income unless one spouse can show that only that spouse's income was deposited to the joint account.

302.8(3) Long-term care limitations. The limitations for premiums for long-term care health insurance set forth in IRC Section 213(d)(10) do not apply for this deduction.

EXAMPLE: A 65-year-old taxpayer who paid \$2,000 in premiums for long-term health insurance for the tax year would be allowed a deduction for Iowa purposes for the entire \$2,000, even though the limitation for the federal deduction for this taxpayer is \$1,800.

This rule is intended to implement Iowa Code section 422.7.

701—302.9(422) Deduction for contributions by taxpayers to the Iowa educational savings plan trust and addition to income for refunds of contributions previously deducted. The Iowa educational savings plan trust (trust) includes the college savings Iowa plan and the Iowa advisor 529 plan. The following subrules provide details on how individuals' net incomes are affected by contributions to beneficiaries' accounts, interest and any other earnings earned on beneficiaries' accounts, and refunds of contributions that were previously deducted. Definitions and other information about establishing college savings Iowa accounts may be found in 781—Chapter 16.

302.9(1) Deduction from net income for contributions made to the trust on behalf of beneficiaries.

a. An individual referred to as a participant can deduct from Iowa net income contributions made by that individual to the trust on behalf of a beneficiary.

b. If a participant makes a contribution to the trust on or after January 1, but on or before the deadline for filing an Iowa individual income tax return, excluding extensions, the participant may elect to have the deduction for the contribution apply to that participant's Iowa individual income taxes for the calendar year immediately preceding the year in which the contribution was made. Once a participant has elected to apply a contribution to the calendar year immediately preceding the year in which the contribution was made, the contribution is deemed to have been made on December 31 of that previous calendar year. Once the election has been made, the deduction for that contribution may only be applied in computing the taxpayer's Iowa net income for the calendar year immediately preceding the year in which the contribution was made. Contributions made on or after January 1, but before the deadline for filing Iowa individual income taxes, that the participant elects to have applied to the immediately preceding calendar year shall count toward the maximum contribution that may be deducted for that previous year. Paragraph 302.9(1) "c" provides more detail.

EXAMPLE: An individual makes a contribution to her Iowa educational savings plan account on April 5. The deadline for filing an Iowa income tax return is April 30 of that year. The individual

elects to have the contribution apply to her prior year's individual income taxes instead of her current year's Iowa individual income taxes. The department will consider the individual's contribution to have been made on December 31 of the prior year. The individual may now claim a deduction for the contribution, up to the annual maximum deduction, on her prior year's Iowa income taxes. However, because the individual elected to have her contribution apply to her prior year's Iowa income taxes, she cannot claim the deduction for the April 5 contribution on her current year's Iowa income taxes.

c. If a taxpayer or spouse participates in the college savings Iowa plan ISave 529 or the Iowa advisor 529 Plan, each may deduct the amount contributed not to exceed the amount published annually by the department per beneficiary. This deduction is only available for contributions to Iowa 529 plans.

302.9(2) *Exclusion of interest and earnings on beneficiary accounts in the trust.* To the extent that interest or other earnings accrue on a beneficiary's account in the trust, the interest or other earnings are excluded for purposes of computing net income of the participant or the beneficiary.

302.9(3) *Amounts refunded to the participant from the Iowa educational savings plan trust that were previously deducted.* The refund or withdrawal of funds is to be included in a participant's net income to the extent that contributions to the account had been deducted in a prior tax year. This amount is to be included if the participant cancels a beneficiary's account in the trust and receives a refund of the funds in the account made on behalf of the beneficiary or if the participant makes a withdrawal from the trust for purposes other than the following.

a. *Qualifying higher education withdrawals.* The payment of qualified higher education expenses as defined in IRC Section 529(e)(3). The term "qualified higher education expenses" does not include tuition expenses related to attendance at an elementary or secondary school.

b. *Qualifying elementary and secondary tuition withdrawals.* The payment of tuition expenses in connection with and required for enrollment or attendance at an elementary or secondary school in Iowa that is accredited under Iowa Code section 256.11 and that adheres to the provisions of the federal Civil Rights Act of 1964 and Iowa Code chapter 216.

(1) These qualified tuition expenses shall not exceed \$20,000 per beneficiary per year. This limitation is based on the beneficiary, not the participant.

(2) Participants are responsible for tracking the amount of qualified tuition expense payments a beneficiary may receive from other participants. If a beneficiary's distributions exceed this annual limitation, the most recent payments are presumed to be the nonqualifying payments. By agreement amongst themselves, account holders are permitted to choose an alternative method for determining which payments are nonqualifying. An alternative method is presumed valid if, after the additions to income required by this paragraph, the beneficiary's total qualifying tax-free withdrawals for elementary or secondary school tuition expenses do not exceed the \$20,000 limitation. However, upon request, the account holders are responsible for providing the department with adequate documentation to substantiate the method used.

c. *Change in beneficiaries.* A change in beneficiaries under, or transfer to another account within, the trust.

d. *ABLE rollovers.* A transfer to the Iowa ABLE savings plan trust, provided such change or transfer is permitted under Iowa Code section 12D.6(5).

EXAMPLE 1: A participant in the Iowa educational savings plan trust canceled the participant agreement for a beneficiary who died during the tax year and received a refund of \$4,200 of funds in the beneficiary's account. Because \$4,000 of the refund represented contributions that the participant had deducted on prior Iowa individual income tax returns, the participant must include \$4,000 of the refund in net income for the tax year.

EXAMPLE 2: Beneficiary A is an elementary school student who attends an accredited elementary school located in Iowa. Participant B and participant C have each opened an Iowa educational savings plan trust account with A as the designated beneficiary. In January, participant B withdraws \$11,000 from B's account to pay A's spring semester tuition. In August, participant C withdraws \$11,000 from C's account to pay for A's fall semester tuition. Although neither B nor C has made a withdrawal in

excess of \$20,000, the limitation is based on the beneficiary, A, who has received a total of \$22,000 in distributions in the tax year. Because A's total distributions have exceeded the annual limitation on distributions related to elementary or secondary school tuition, the participants must include the \$2,000 excess in their net income. Because C's withdrawal was made after B's, the entire excess is presumed attributable to C, and therefore, C must include the entire \$2,000 excess in C's Iowa net income unless B and C can show that they agreed to an alternative method of allocating the excess amount.

This rule is intended to implement Iowa Code section 422.7.

701—302.10(422) Section 179 expensing.

302.10(1) *In general.* Iowa taxpayers who elect to expense certain depreciable business assets in the year the assets were placed in service under IRC Section 179 must also expense those same assets for Iowa income tax purposes in that year.

302.10(2) *Claiming the deduction.*

a. Timing and requirement to follow federal election. A taxpayer who takes a federal section 179 deduction must also take the deduction for the same asset in the same year for Iowa purposes.

b. Qualifying for the deduction. Whether a specific business asset qualifies for a section 179 deduction is determined by the IRC and applicable federal regulations for both federal and Iowa purposes.

c. Amount of the Iowa deduction. Generally, the Iowa deduction must equal the amount of the federal deduction taken for the same asset in the same year, subject to special Iowa limitations. The following chart provides a comparison of the Iowa and federal section 179 dollar limitations and reduction limitations. Rule 701—502.10(422) provides section 179 rules applicable to corporations (both C and S corporations) and other entities subject to the corporate income tax, while rule 701—602.10(422) provides section 179 rules applicable to financial institutions subject to the franchise tax.

Section 179 Deduction Allowances Under Federal and Iowa Law				
Tax Year	Federal		Iowa	
	Dollar Limitation	Reduction Limitation	Dollar Limitation	Reduction Limitation
2003	\$ 100,000	\$ 400,000	\$ 100,000	\$ 400,000
2004	102,000	410,000	102,000	410,000
2005	105,000	420,000	105,000	420,000
2006	108,000	430,000	108,000	430,000
2007	125,000	500,000	125,000	500,000
2008	250,000	800,000	250,000	800,000
2009	250,000	800,000	133,000	530,000
2010	500,000	2,000,000	500,000	2,000,000
2011	500,000	2,000,000	500,000	2,000,000
2012	500,000	2,000,000	500,000	2,000,000
2013	500,000	2,000,000	500,000	2,000,000
2014	500,000	2,000,000	500,000	2,000,000
2015	500,000	2,000,000	500,000	2,000,000
2016	500,000	2,010,000	25,000	200,000
2017	510,000	2,030,000	25,000	200,000
2018	1,000,000	2,500,000	70,000	280,000
2019	1,020,000	2,550,000	100,000	400,000

2020 and later	Iowa limitations are the same as federal
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d. Reduction. Both the federal and the Iowa deductions for section 179 assets are reduced (phased out dollar for dollar) for taxpayers whose total section 179 assets placed in service during a given year cost more than the amount specified (reduction limitation) for that year.

e. Income limitation. The Iowa section 179 deduction for any given year is limited to the taxpayer's income from active conduct in a trade or business in the same manner that the section 179 deduction is limited for federal purposes. If an allowable Iowa section 179 deduction exceeds the taxpayer's business income for Iowa purposes for a given year, any excess may be carried forward as described in paragraph 302.10(2) "g."

f. Carryforward. As with the federal deduction, allowable Iowa section 179 deductions claimed in a given year that exceed a taxpayer's business income may be carried forward and claimed in future years.

EXAMPLE: A taxpayer purchases a \$100,000 piece of equipment and places it in service in 2019. The taxpayer claims a section 179 deduction of \$100,000 for the full cost of the equipment on the 2019 federal return. The taxpayer is also required to claim a section 179 deduction of \$100,000 on the 2019 Iowa return (because the federal deduction is equal to the Iowa limit for the year, the Iowa and federal deductions are the same). However, the taxpayer has only \$50,000 in business income for 2019, so the allowable deduction for that year is limited to \$50,000. The remaining \$50,000 may be carried forward and applied as a section 179 deduction (subject to all limitations) in 2020 and in any future years until the amount is fully deducted.

g. Differences in basis. Iowa adjustments for differences between the Iowa and federal section 179 deduction limitations may cause the taxpayer to have a different basis in the same asset for Iowa and federal purposes. Taxpayers are required to use forms made available on the department's website to calculate and track these differences.

This rule is intended to implement Iowa Code section 422.7.

701—302.11(422) Exemption of active duty pay for armed forces, armed forces military reserve, or the national guard. All pay received from the federal government for military service performed while on active duty status in the armed forces, armed forces military reserve, or national guard is excluded from Iowa net income to the extent the pay was included in federal taxable income.

302.11(1) Definition of active duty personnel. Active duty personnel who qualify for the exclusion include the following:

a. Active duty members of the regular armed forces, which include the Army, Navy, Marines, Air Force, Coast Guard, and Space Force of the United States.

b. Members of a reserve component of the Army, Navy, Marines, Air Force, Coast Guard, and Space Force who are on an active duty status as defined in Title 10 of the United States Code (10 U.S.C.).

c. Members of the national guard who are in an active duty status as defined in 10 U.S.C.

302.11(2) Military personnel who do not qualify. Military personnel who do not qualify for the exclusion include the following:

a. Members of a reserve component of the Army, Navy, Marines, Air Force, Coast Guard, and Space Force who are not in an active duty status as defined in 10 U.S.C.

b. Full-time members of the national guard who perform duties in accordance with 32 U.S.C.

c. Other members of the national guard who are not in an active duty status as defined in 10 U.S.C.

d. Other members of the national guard who do not receive pay from the federal government.

302.11(3) Income from nonmilitary activities. Any wages earned from nonmilitary wages for personal services conducted in Iowa by both residents and nonresidents of Iowa will still be subject to Iowa individual income tax. In addition, both residents and nonresidents of Iowa who earn income from businesses, trades, professions or occupations operated in Iowa that are unrelated to military activity will be subject to Iowa individual income tax on that income.

302.11(4) Exemption from Iowa withholding. Active duty personnel meeting the requirements of subrule 302.11(1) who are receiving pay from the federal government that is exempt from Iowa individual income tax may complete an IA W-4 Employee Withholding Allowance Certificate and claim exemption from Iowa income tax for active duty pay received from the federal government.

This rule is intended to implement Iowa Code section 422.7.

701—302.12(422) Exemption for military retirement pay. Retirement pay received by taxpayers from the federal government for military service performed in the armed forces, armed forces reserves, or national guard is exempt from state income tax. In addition, amounts received by a surviving spouse, former spouse, or other beneficiary of a taxpayer who served in the armed forces, armed forces reserves, or national guard under the Survivor Benefit Plan are also exempt from state income tax. The retirement pay is only excluded from Iowa net income to the extent it is included in the taxpayer's federal taxable income.

302.12(1) Coordination with pension exclusion. Taxpayers who receive retirement pay under federal law that combines retirement pay for both uniformed service and the federal civil service retirement system or federal employees' retirement system must prorate the retirement pay based on years of service.

EXAMPLE: A single taxpayer who is not disabled and is 50 years of age receives \$60,000 as a federal pension during the tax year. The taxpayer has 20 years of military service and 10 years of civilian employment with the federal government. The military retirement pay portion is \$40,000 (20 years, divided by 30 years, multiplied by \$60,000). The taxpayer can exclude \$40,000 of military retirement pay. The taxpayer cannot exclude the \$20,000 of civilian retirement pay since it does not qualify for the exclusion in rule 701—302.7(422) because the taxpayer is under 55 years of age and is not disabled.

302.12(2) Coordination with filing threshold and alternate tax. The military retirement pay is excluded from the calculation of income used to determine whether an Iowa income tax return is required to be filed pursuant to Iowa Code section 422.13. In addition, the military retirement pay is excluded from the calculation of the special tax computation for all low-income taxpayers, except single taxpayers pursuant to Iowa Code section 422.5(2) "a," and is excluded from the calculation of the special tax computation for taxpayers who are 65 years of age or older under Iowa Code section 422.5(3) "a."

302.12(3) Iowa withholding. The amount of military retirement pay is excluded from the calculation of payments used to determine whether Iowa tax should be withheld from pension and annuity payments as determined pursuant to 701—subrule 307.4(4).

This rule is intended to implement Iowa Code sections 422.5 and 422.7.

701—302.13(422) Iowa ABLE savings plan trust. The Iowa ABLE savings plan program is administered by the treasurer of state under the terms of Iowa Code chapter 12I. The following subrules provide details about how an individual's net income is affected by contributions to a beneficiary's account, by interest and any other earnings on a beneficiary's account, and by distributions of contributions that were previously deducted.

302.13(1) Definitions.

"Account owner" means an individual who enters into a participation agreement under Iowa Code chapter 12I for the payment of qualified disability expenses on behalf of a designated beneficiary.

"Designated beneficiary" means an individual who is a resident of this state or a resident of a contracting state and who meets the definition of "eligible individual" in IRC Section 529A.

"Iowa ABLE savings plan trust" means a qualified ABLE program administered by the Iowa treasurer of state under the terms of Iowa Code chapter 12I.

"Other qualified ABLE program" refers to any qualified ABLE program administered by another state with which the Iowa treasurer of state has entered into an agreement under the terms of Iowa Code section 12I.10 (more information is available in subrule 302.13(2)).

"Qualified ABLE program" means the same as defined in IRC Section 529A.

“*Qualified disability expenses*” means the same as defined in IRC Section 529A.

302.13(2) *Contracting with other states.* Iowa Code section 12I.10 allows the treasurer of state to choose to defer implementation of Iowa’s own qualified ABLE program and instead enter into an agreement with another state that already has a qualified ABLE program to provide Iowa residents access to that state’s qualified ABLE program, provided that the other state’s program meets the qualifications set out in Iowa Code section 12I.10(1).

302.13(3) *Subtraction from net income for contributions made to the Iowa ABLE savings plan trust or other qualified ABLE program.* Individuals can subtract from their Iowa net income the amount contributed to the Iowa ABLE savings plan trust or other qualified ABLE program on behalf of a designated beneficiary during the tax year, subject to the maximum contribution level for that year. This subtraction is not allowed for any contribution that is a transfer from an Iowa educational savings plan trust account and that was previously deducted as a contribution to the Iowa educational savings plan trust.

302.13(4) *Exclusion of interest and earnings on beneficiary accounts in the Iowa ABLE savings plan trust or other qualified ABLE program.* A taxpayer may exclude from Iowa net income interest or other earnings that accrue on an account in the Iowa ABLE savings plan trust or other qualified ABLE program if the account owner is an Iowa resident.

302.13(5) *Addition to net income of amounts distributed to the participant from the Iowa ABLE savings plan trust or other qualified ABLE program that had previously been deducted.*

a. If an account owner cancels their account in the Iowa ABLE savings plan trust or other qualified ABLE program and receives a distribution of the funds in the account, the amount of the distribution shall be included in the account owner’s net income to the extent that contributions to the account had been deducted in a prior tax year by the account owner or any other person as a contribution to the Iowa ABLE savings plan trust or other qualified ABLE program or as a contribution to an Iowa educational savings plan trust account.

b. If a taxpayer makes a withdrawal of funds previously deducted by the taxpayer or any other person from the Iowa ABLE savings plan trust or other qualified ABLE program for purposes other than the payment of qualified disability expenses, the amount of the withdrawal shall be included in the Iowa net income to the extent that contributions to the account had been deducted in a prior tax year by the taxpayer or any other person as contributions to a qualified ABLE program or an Iowa educational savings plan trust account.

302.13(6) *Maximum contribution level.* The amount of the deduction available for an individual taxpayer each year for contributions on behalf of any one designated beneficiary to the Iowa ABLE savings plan trust or other qualified ABLE program cannot exceed the maximum contribution level for that year. The maximum contribution level is set by the treasurer of state. The maximum contribution level is indexed yearly for inflation pursuant to Iowa Code section 12D.3(1).

This rule is intended to implement Iowa Code section 422.7.

701—302.14(422,541B) First-time homebuyer savings accounts.

302.14(1) *Definitions.* Definitions that apply to the first-time homebuyer savings account program may be found in Iowa Code section 541B.2.

302.14(2) *Establishing an account.*

a. Account holders.

(1) A first-time homebuyer savings account holder must be an individual or married couple.

(2) Any individual may establish a first-time homebuyer savings account by opening an account that meets the requirements provided in this rule.

(3) A married couple who files a joint Iowa income tax return may establish a joint first-time homebuyer savings account by opening a joint savings account that meets the requirements provided in this rule. Married couples who file separately for Iowa income tax purposes cannot establish a joint first-time homebuyer savings account.

(4) There is no limit on the number of first-time homebuyer savings accounts that any account holder may open. However, account holders are subject to other restrictions under the Iowa Code and these rules, including but not limited to the annual contribution limits and aggregate lifetime limits in paragraph 302.14(4) “c.”

(5) No account holder may open or hold more than one account for the same designated beneficiary.

(6) The account holder may change the designated beneficiary of the account at any time.

(7) No new accounts can be opened on or after July 1, 2026.

b. Beneficiaries.

(1) In order to be a designated beneficiary of a first-time homebuyer savings account, an individual must:

1. Be a resident of Iowa, as defined in Iowa Code section 422.4,

2. Not own, either individually or jointly, any single-family or multifamily residence, and

3. Not have owned or purchased, individually or jointly, any single-family or multifamily residence at any time in the three years immediately prior to both:

- The date on which the individual is designated the beneficiary of a first-time homebuyer savings account, and

- The date of the qualified home purchase for which the eligible home costs are paid or reimbursed from the first-time homebuyer savings account.

(2) The designated beneficiary may also be the account holder.

(3) Each account shall have only one designated beneficiary.

(4) The account holder must designate a beneficiary, on forms provided by the department, by April 30 of the year immediately following the tax year in which the account holder opened the account.

c. Account requirements. To qualify as a first-time homebuyer savings account, the account must be:

(1) An interest-bearing savings account meeting the qualifications for a savings deposit under 12 CFR §204.2(d),

(2) At a state or federally chartered bank, savings and loan association, credit union, or trust company in Iowa, and

(3) Used exclusively as a first-time homebuyer savings account in compliance with the requirements of this rule.

302.14(3) Maintaining the account.

a. Contributing to the account.

(1) Any person may make cash contributions to a first-time homebuyer savings account. Cash contributions may be made by people other than the account holder or the beneficiary. However, only the account holder may claim a deduction for contributing to a first-time homebuyer savings account, as described in subrule 302.14(4).

(2) There is no limit on the amount of contributions that may be made to or retained in a first-time homebuyer savings account. However, there are restrictions on the amounts that can be deducted from Iowa net income, as described in subrule 302.14(4).

b. Documenting transactions.

(1) Annual reports. For each tax year beginning with the tax year in which the first-time homebuyer savings account is established, the account holder must submit a report to the department showing all account activity during the tax year. The report shall be included with the taxpayer's Iowa individual income tax return and must show the account number of, all deposits into, and withdrawals from the first-time homebuyer savings account, along with any other information required by the forms provided by the department.

(2) Withdrawal reports. All withdrawals must be reported, on forms provided by the department, within 90 days of the date of the withdrawal or, for withdrawals made less than 90 days before an account holder files an income tax return with the department, no later than the date the return is

filed. Account holders must report both withdrawals for eligible home costs and any nonqualifying withdrawals. Any withdrawal that appears on the annual report but that is not properly reported at the time it is made shall be deemed to be a nonqualifying withdrawal that must be included in the account holder's Iowa net income for the tax year in which the withdrawal was made.

(3) *Account fees.* Fees and charges for the maintenance of the account that are deducted from the account by the financial institution in which the first-time homebuyer savings account is held shall not be considered withdrawals for the purposes of the reporting requirements described in paragraph 302.14(3) "b."

c. *Nonqualifying withdrawals.* Funds may be withdrawn from a first-time homebuyer savings account at any time. However, once any nonqualifying withdrawal, as defined in subparagraph 302.14(5) "a"(2), is made, the account holder may no longer claim the Iowa income tax benefits related to the first-time homebuyer savings account described in subrule 302.14(4). Furthermore, any nonqualifying withdrawal shall also result in an addition to income and penalty as described in subrule 302.14(5).

d. *Ten-year limitation.* An account shall not remain designated a first-time homebuyer savings account for more than ten years, beginning with the year in which the account was first opened. Any funds remaining in the account on January 1 of the tenth calendar year following the year in which the account holder first opened the account shall be deemed immediately withdrawn and may be subject to Iowa income taxes and penalties as described in subrule 302.14(5). The account holder has no obligation to close the account, but as of January 1 of the tenth calendar year after the year in which the account was opened, the account will no longer be a first-time homebuyer savings account entitled to the Iowa income tax benefits described in this rule. A change in the designated beneficiary of the account does not extend the ten-year period in which the account holder may maintain a first-time homebuyer savings account; the period still runs from the year the account was first opened.

e. *Exclusively first-time homebuyer account.* For an account to qualify as a first-time homebuyer savings account, the account holder shall use the account exclusively as a first-time homebuyer savings account consistent with these rules.

f. *Withdrawal for deposit into FirstHome Iowa program trust account.* First-time homebuyer account balances may be withdrawn without penalty or taxation in Iowa if such withdrawal is deposited in an account within the FirstHome Iowa program trust under Iowa Code chapter 12L within 30 days of the withdrawal.

302.14(4) Deductions.

a. *Deduction for contributions.* Any funds contributed to the first-time homebuyer savings account by the account holder during the tax year may be deducted from the account holder's net income for that tax year, subject to the limitations described in paragraph 302.14(4) "c." Although anyone may contribute funds to the first-time homebuyer savings account, only the account holder may claim the deduction, and the deduction may be claimed only for amounts the account holder personally contributed.

b. *Deduction for interest.* To the extent that any interest earned on the funds in a first-time homebuyer savings account is included in the account holder's Iowa net income for a tax year, the amount of that interest may be deducted from the account holder's net income for that tax year, subject to the lifetime limitation.

c. Limitations.

(1) *Annual limitation.* The deduction described in paragraph 302.14(4) "a" is subject to the limitations described in Iowa Code section 422.7(27) "a"(1).

(2) *Lifetime limitation.* Account holders are subject to an aggregate lifetime limit on the deductions described in paragraphs 302.14(4) "a" and "b" as described in Iowa Code section 422.7(27) "b."

(3) *Annual publication of limitations.* Each year, the department will provide the annual contribution limit as indexed for inflation and the lifetime limit applicable to account holders who open accounts during that year on the department's website.

302.14(5) Additions to income.

a. Nonqualifying withdrawals.

(1) Addition to income. If there is any nonqualifying withdrawal, as defined in subparagraph 302.14(5)“a”(2), during the tax year, the account holder must add to the account holder’s Iowa net income for that year the full amount of the nonqualifying withdrawal, to the extent such income was previously deducted under paragraph 302.14(4)“a.” Any nonqualifying withdrawal also makes the account holder ineligible to claim any further deductions described in subrule 302.14(4) in any future tax year.

(2) Nonqualifying withdrawal defined.

1. Any withdrawal from a first-time homebuyer savings account for any purpose other than the payment or reimbursement of the designated beneficiary’s eligible home costs in connection with a qualified home purchase is a nonqualifying withdrawal. A nonqualifying withdrawal includes but is not limited to a withdrawal caused by the death of the account holder and withdrawal made pursuant to garnishment, levy, bankruptcy order, or any other order. If a nonqualifying withdrawal occurs, the account holder cannot cure the nonqualifying withdrawal by returning funds to the account.

2. A withdrawal shall be presumed to be a nonqualifying withdrawal unless:

- Ownership of the qualifying home that the funds from the account are used to purchase passes to the designated beneficiary within 60 days of the date the funds are withdrawn, and
- The designated beneficiary actually occupies the home as the designated beneficiary’s primary residence within 90 days of the date the funds are withdrawn.

3. Notwithstanding subparagraph 302.14(5)“a”(2), any amount transferred between different first-time homebuyer savings accounts of the same account holder by a person other than the account holder shall not be considered a nonqualifying withdrawal.

b. Unused funds. Any amount remaining in a first-time homebuyer savings account on January 1 of the tenth calendar year after the calendar year in which the account holder first opened any first-time homebuyer savings account shall be considered immediately withdrawn.

c. Penalties. For any amount considered a withdrawal required to be added to net income pursuant to this subrule, the account holder shall be assessed a penalty equal to 10 percent of the amount of the withdrawal. The penalty shall not apply to withdrawals made by reason of the death of the account holder or to withdrawals made pursuant to a garnishment, levy, or other order, including but not limited to an order in bankruptcy following a filing for protection under the federal Bankruptcy Code, 11 U.S.C. §101 et seq.

d. Examples.

EXAMPLE 1: Taxpayer eligible for the deduction; no addition to income or penalty from nonqualifying withdrawal. A is an individual. A creates a new interest-bearing savings account with a financial institution. A submits a form to the department designating the account as a first-time homebuyer savings account and designating Z, an Iowa resident who has never owned a home, as the beneficiary of the account. A contributes \$1,000 per year to the first-time homebuyer savings account over a period of four years. Every year, A timely submits the required annual reports and all accompanying information. After four years, Z made a qualified home purchase. A withdrew the entire balance of the first-time homebuyer savings account and applied the amount to eligible home costs. Within 90 days of withdrawing the funds, A submitted the required withdrawal report and the necessary supporting documentation to the department.

Result: A is allowed to deduct from net income the amount of the contributions generated from the first-time homebuyer account, since the yearly contributions are below the annual limits. A is allowed to deduct \$1,000 each year for the four-year period A made contributions. Additionally, A is allowed to deduct income from interest generated from the account each year. A does not have any addition to net income or any penalties associated with the withdrawal or usage of the funds.

EXAMPLE 2: Nonqualifying withdrawal of entire account due to voluntary withdrawal by A. Assume the same facts as Example 1. However, rather than making a qualified withdrawal, A

withdraws the entire balance of the first-time homebuyer savings account and pays for Z's college tuition.

Result: The withdrawal is a nonqualified withdrawal. Any withdrawal that is not for eligible home costs is a nonqualified withdrawal. A's nonqualified withdrawal has three results. First, the amount of the nonqualified withdrawal is added back to A's net income for the tax year in which the nonqualified withdrawal occurred (Iowa Code section 422.7(27) "c"(1)). Second, A will be assessed a penalty equal to 10 percent of the total contributions that A previously deducted (Iowa Code section 422.7(27) "d"). Third, A will no longer be able to claim the first-time homebuyer deduction in any future tax years (Iowa Code section 422.7(27) "b"(2)(b)). A is barred from claiming the first-time homebuyer deduction in the future, even if A attempts to open a first-time homebuyer account for a different beneficiary in a different tax year.

EXAMPLE 3: Nonqualifying withdrawal of entire account by legal process. Assume the same facts as Example 1. However, rather than a qualifying withdrawal occurring, a creditor levies the entire balance of the first-time homebuyer account in order to satisfy A's debt to the creditor.

Result: The levy is a nonqualified withdrawal. Any withdrawal, including a withdrawal that is caused by a legal process not initiated by A, that is not for a qualified home purchase is a nonqualified withdrawal. Example 3 has the same result as Example 2, except in Example 3, A does not incur a 10 percent penalty because the withdrawal was due to a levy (Iowa Code section 422.7(27) "d").

EXAMPLE 4: Nonqualifying withdrawal of a partial balance of a first-time homebuyer savings account. Assume the same facts as Example 1, except A withdraws \$1,000 from the account in order to pay for personal expenses.

Result: The \$1,000 withdrawal is a nonqualifying withdrawal. A must file a withdrawal report with the department within 90 days of the withdrawal. The \$1,000 withdrawal will result in the addition of \$1,000 to A's net income. A will also be assessed a \$100 penalty. The balance of the first-time homebuyer account is \$3,100. Subject to the ten-year limitation and the other requirements of the deduction, A may use the remaining \$3,100 for Z's eligible home costs before the ten-year period expires. If A does so, A will not have the \$3,000 added back to A's net income or face any penalties associated with the \$3,000 eligible home costs. A will be prohibited from claiming the first-time homebuyer deduction for any period after the date of the nonqualified withdrawal. This is true even if A attempts to repay the \$1,000 withdrawal or if A attempts to open any other first-time homebuyer accounts.

EXAMPLE 5: No withdrawals made within ten years of opening the account. Assume the same facts as Example 1, except A does not make a withdrawal within ten years of opening the account. The account is no longer a first-time homebuyer savings account, and the entire account balance is deemed to have been withdrawn in a nonqualifying withdrawal. A is required to include the entire \$10,000 previously deducted for contributions to the account in net income in the tax year following the expiration of the ten-year period and pay a \$1,000 penalty for the nonqualifying withdrawal. A can no longer open a new first-time homebuyer savings account or take any deductions for contributions made to another account under the program.

EXAMPLE 6: Divorce between taxpayers with a joint account. A and B are a married couple who file a joint Iowa income tax return. A and B open a joint savings account and take the necessary steps to designate it as a joint first-time homebuyer savings account. A and B contribute \$2,000 to the account and deduct the full amount on their joint Iowa income tax return. They contribute the same amount, file joint returns, and deduct the full amount in the next three tax years. In the fifth tax year, A and B divorce. The divorce decree divides the funds in the account evenly between A and B. When the funds from the account are distributed between A and B, the entire withdrawal is deemed to be a nonqualifying withdrawal and A and B are jointly and severally liable for the payment of the tax and penalty due on the entire amount that they previously deducted for contributions to the first-time homebuyer savings account.

Alternatively, prior to the divorce decree, A and B can each open a new first-time homebuyer savings account individually. If the divorce decree orders that funds from the original joint first-time

homebuyer savings account be transferred to A's and B's new individual accounts, the funds may be transferred without triggering a nonqualifying withdrawal. A and B will not be subject to taxes or penalties on their previous contributions to the account, and each will still be eligible to take deductions for contributions to their new accounts, subject to the applicable limitations. The transfer must occur as a direct result of a court order; if A or B transfers funds themselves, the transfer is deemed to be a nonqualifying withdrawal.

Even if the funds in A and B's original joint account are successfully transferred without triggering a nonqualifying withdrawal as described above, both A and B will still be jointly and severally liable for any tax or penalty due on any nonqualifying withdrawal that either makes later up to the amount they deducted on their joint returns prior to the divorce.

EXAMPLE 7: Death of the account holder. Assume the same facts as Example 1, except after contributing to the account for four years, A dies without having withdrawn any funds from the account either for a qualifying home purchase for Z or for any other reason. All of the funds in the account are deemed immediately withdrawn at the time of A's death. Because this is a nonqualifying withdrawal, the \$4,000 in contributions that A previously deducted must be included as income on A's final return. However, because the reason for the deemed withdrawal was A's death, the 10 percent penalty is not included on A's final return.

This rule is intended to implement Iowa Code section 422.7 and chapter 541B.

701—302.15(422,12L) FirstHome Iowa accounts.

302.15(1) General provisions. General provisions that apply to the FirstHome Iowa accounts may be found in Iowa Code chapter 12L.

302.15(2) Withdrawal for deposit into FirstHome Iowa program trust account. First-time homebuyer account balances may be withdrawn without penalty or taxation in Iowa if such withdrawal is deposited in an account within the FirstHome Iowa program trust under Iowa Code chapter 12L within 30 days of the withdrawal.

302.15(3) Cancellation of agreement. Iowa Code section 12L.5 governs the cancellation of a participant agreement.

302.15(4) Deductions.

a. Deduction for contributions. Any funds contributed to the FirstHome Iowa account by the account participant during the tax year may be deducted from the account participant's net income for that tax year, subject to the limitations described in paragraph 302.15(4) "c." Although anyone may contribute funds to the first-time homebuyer savings account, only the account holder may claim the deduction, and the deduction may be claimed only for amounts the account holder personally contributed.

b. Deduction for interest. To the extent that any interest earned on the funds in a FirstHome Iowa account is included in the account participant's Iowa net income for a tax year, the amount of that interest may be deducted from the account participant's net income for that tax year, subject to the lifetime limitation described in subparagraph 302.15(4) "c"(2).

c. Annual limitation. The deduction described in paragraph 302.15(4) "a" is subject to the limitations described in Iowa Code section 12L.3(1).

302.15(5) Additions to income. Any withdrawal from a FirstHome Iowa account for any purpose other than a qualified homebuyer expense, described in Iowa Code section 12L.1(2) "j," is a nonqualifying withdrawal. A nonqualifying withdrawal includes but is not limited to a withdrawal caused by the death of the account holder, cancellation of a participation agreement, and a withdrawal made pursuant to garnishment, levy, bankruptcy order, or any other order. If a nonqualifying withdrawal occurs, the account holder cannot cure the nonqualifying withdrawal by returning funds to the account.

This rule is intended to implement Iowa Code chapter 12L and section 422.7.

701—302.16(422) Broadband infrastructure grant exemption.

302.16(1) General. Certain qualifying communications service providers may subtract, to the extent included in net income, the amount of qualifying government grants used to install broadband infrastructure that facilitates broadband service in targeted service areas at or above download and upload speeds identified by the Federal Communications Commission pursuant to Section 706 of the federal Telecommunications Act of 1996 as amended.

302.16(2) Definitions.

“Facilitate” shall have the same meaning as defined in Iowa Code section 8.76.

“Grant” means a transfer for a governmental purpose of money or property to a transferee that is not a related party to or an agent of the transferor. The transfer must not impose any obligation or condition to directly or indirectly repay any amount to the transferor or a related party. Obligations or conditions intended solely to assure expenditure of the transferred moneys in accordance with the governmental purpose of the transfer do not prevent a transfer from being a grant.

1. *“Federal grant”* means any grant issued by the United States government, including any agency or instrumentality thereof.

2. *“State grant”* means any grant issued by any state of the United States, the District of Columbia, or a territory or possession of the United States, including any agency or instrumentality thereof.

3. *“Local grant”* means any grant issued by any city, county, township, school district, or any other unit of local government, including any agency or instrumentality thereof.

This rule is intended to implement Iowa Code 422.7.

701—302.17(422) Interest expense deduction adjustments. The limit on the amount of business interest expense that a taxpayer may deduct in a taxable year under IRC Section 163(j) does not apply for Iowa purposes. This rule provides information on how taxpayers must calculate and report their business interest expense deduction for Iowa purposes. All references to the Code of Federal Regulations (*“Treas. Reg.”* or *“CFR”*) and certain other information in this rule are based on final Internal Revenue Service (IRS) regulations and guidance in effect on January 13, 2021.

302.17(1) Definitions. The following terms apply to the interpretation and application of this rule.

“Current-year business interest expense” means the same as defined in Treas. Reg. Section 1.163(j)-1(b)(9).

“Excess business interest expense” means the same as defined in Treas. Reg. Section 1.163(j)-1(b)(16).

“Iowa partnership” means any entity required to file an Iowa return (IA 1065) for the relevant tax year.

“Iowa S corporation” means any S corporation required to file an Iowa return (IA 1120S) for the relevant tax year.

“Non-Iowa partnership” means any entity that is not required to file an Iowa return (IA 1065) for the relevant tax year.

“Non-Iowa S corporation” means any S corporation that is not required to file an Iowa return (IA 1120S) for the relevant tax year.

302.17(2) Individual business interest expense. Iowa does not conform with the IRC Section 163(j) business interest expense deduction limitation. The following adjustments may be required for corporations due to this nonconformity.

a. Current-year business interest expense. A taxpayer’s current-year business interest expense is fully deductible to the extent permitted by IRC Section 163 for Iowa purposes without regard to any limitation under IRC Section 163(j). Even though Iowa does not conform to IRC Section 163(j), provisions of the IRC other than Section 163(j) may subject interest expense to disallowance, deferral, capitalization, or other limitations, and those other provisions of the IRC still generally apply for Iowa purposes. No additional Iowa adjustments are permitted for federal limitations such as those described

in Treas. Reg. Section 1.163(j)-3(b)(4), which are determined after the application of IRC Section 163(j) for federal purposes. Treas. Reg. Section 1.163(j)-3 contains examples of other provisions of the IRC that may restrict interest expense deductions for federal and Iowa purposes, independent of the IRC Section 163(j) limitation.

b. Carryforward. When current-year interest expense is limited at the federal level, the disallowed business interest expense, as defined in Treas. Reg. Section 1.163(j)-1(b)(10), is carried forward to be deducted in future years for federal purposes when certain conditions are met. Iowa law allows taxpayers to fully deduct current-year business interest expense, and no amounts are carried forward for Iowa purposes. Disallowed business interest expense carryforward amounts from prior years, including excess business interest expense allocated to a partner in a prior year, cannot be deducted for Iowa purposes. All prior-year disallowed business interest expense carryforward amounts deductible under IRC Section 163(j) in the current year at the federal level, including excess business interest expense allocated to a partner in a prior year, must be added back in computing the taxpayer's Iowa income for the year.

EXAMPLE: In 2020, taxpayer X has \$100,000 in current-year business interest expense. For federal purposes, X is subject to the IRC Section 163(j) limitation. X deducts \$70,000 in business interest expense on X's federal return and carries the remaining \$30,000 forward to be deducted in future years. For Iowa purposes, X deducts the full \$100,000 in current-year business interest expense.

In 2021, X has \$50,000 in current-year business interest expense. For federal purposes, X is permitted to deduct the full \$50,000 in interest expense generated in the current year, plus \$5,000 of the amount that was disallowed in the previous year for a total federal deduction of \$55,000. X must add the federal carryforward amount (\$5,000) back to X's current year Iowa net income, limiting X's Iowa deduction to the \$50,000 in current-year business interest expense.

302.17(3) Partners and partnerships.

a. Partnership-level adjustments. An Iowa partnership that is subject to the IRC Section 163(j) limitation for federal purposes is permitted to deduct all current-year business interest expense at the partnership level in that tax year for Iowa purposes.

(1) Excess business interest expense. A partnership may include as a reduction on the partnership's Iowa income tax return any excess business interest expense, as defined in Treas. Reg. Section 1.163(j)-1(b)(16), of the partnership that was disallowed and allocated to the partners for that tax year for federal purposes.

(2) Tiered partnerships. For partnerships that receive excess business interest expense passed through from a partnership in which they are a partner, paragraph 302.17(3) "b" contains information on how to report Iowa adjustments for that passed-through income.

b. Partner-level adjustments.

(1) Interest expense from Iowa partnerships. Iowa adjustments related to excess business interest expense of an Iowa partnership are made at the entity level as described in subparagraph 302.17(3) "a"(1) and are reported to partners on an IA 1065 Schedule K-1. Partners are not permitted to make any Iowa adjustment at the partner level to their federal interest expense deduction for amounts of excess business interest expense allocated from an Iowa partnership on the partner's federal Schedule K-1 related to that Iowa partnership.

EXAMPLE 1: P, a partnership doing business in Iowa, has \$100,000 in current-year business interest expense. For federal purposes, \$20,000 of that amount is disallowed under IRC Section 163(j). The partnership deducts \$80,000 at the entity level, and the remaining disallowed \$20,000 is allocated to the partners to be deducted in future years. For Iowa purposes, the \$80,000 of business interest expense allowed for federal purposes is included in the partnership's non-separately stated ordinary business income (loss) and the partnership will make an adjustment on the entity's IA 1065 to deduct the \$20,000 of current-year business interest expense that was disallowed for federal purposes. The \$20,000 additional Iowa deduction will be reported to the partners as an all source modification on the partners' IA 1065 Schedules K-1, and partners will receive the benefit of this all source modification item when the partners report their Iowa partnership income on their own Iowa tax return for the year.

The partners will not be permitted to make further Iowa adjustments on their own Iowa tax return for the excess business interest expense amounts passed through to them from the partnership for federal purposes.

(2) Interest expense from non-Iowa partnerships. Partners may include as part of their Iowa business interest expense deduction the total amount of current-year excess business interest expense deduction passed through to them from all non-Iowa partnerships as shown on the federal Schedule K-1 (Form 1065), line 13, code K.

EXAMPLE 2: X is an Iowa resident and a partner in P2, an out-of-state partnership with no business in Iowa and no Iowa filing obligation. P2 has \$100,000 in current-year business interest expense and is subject to the IRC Section 163(j) limitation for federal purposes. At the entity level, P2 is permitted to deduct \$80,000 on its federal partnership return. The \$20,000 in excess business interest expense is then allocated to P2's partners. X is allocated \$5,000 in excess business interest expense from P2. Because P2 is not required to file an Iowa return, and therefore X did not receive an IA 1065 Schedule K-1 from P2, X is permitted to deduct the \$5,000 allocated from P2 as current-year business interest expense on X's Iowa income tax return.

(3) Partnership basis. A partner's basis is reduced (but not below zero) by the amount of excess business interest expense the partnership passes through to the partner each year. Treas. Reg. Section 163(j)-6(h) contains detailed information about how to make these basis adjustments. For federal purposes, immediately before disposition of the partnership interest, the partner's basis is then increased by the amount of any passed-through business interest expense that has not yet been treated as paid or accrued by the partner as described in Treas. Reg. Section 163(j)-6(h)(3). No basis increase at the time of disposition is allowed for Iowa purposes for passed-through business interest expense amounts that were deducted for Iowa but not for federal purposes due to Iowa's nonconformity with IRC Section 163(j).

302.17(4) S corporation adjustments. For federal purposes, IRC Section 163(j) limitations are applied at the S corporation level. Unlike partnerships, disallowed business interest expense amounts are carried forward and deducted in future years at the entity level rather than being passed through to shareholders. Rule 701—502.12(422) contains more information about the IRC Section 163(j) adjustments required for corporations, including S corporations, for Iowa purposes. In addition, Treas. Reg. Section 1.163(j)-6(l) contains more information about the application of IRC Section 163(j) to S corporations for federal purposes.

This rule is intended to implement Iowa Code section 422.7(60).

701—302.18(422) Capital gain deduction for certain types of net capital gains. Information relating to the Iowa capital gain deduction available for tax years prior to January 1, 2023, can be found in prior versions of rule 701—302.38(422). Prior versions of the Iowa Administrative Code are located here: www.legis.iowa.gov/law/administrativeRules/agencies. Net capital gains from the sale of real property used in a farming business and the sale of certain livestock described in subrules 302.18(5) and 302.18(6) may be excluded from net income for qualified individual taxpayers. To exclude qualifying capital gains, a taxpayer has to meet certain holding period and material participation requirements unless otherwise indicated in this rule.

302.18(1) Definitions. Unless otherwise indicated in this rule or required by the context, all words and phrases used in this rule that are defined under Iowa Code section 422.7(13) shall have the same meaning as provided to them under that Iowa Code section.

“Disabled individual” means an individual who is receiving benefits as a result of retirement from employment or self-employment due to disability. “Disabled individual” includes an individual who is determined disabled in accordance with criteria established by the Social Security Administration or other federal or state governmental agency.

302.18(2) Material participation. If the taxpayer has regular, continuous, and substantial involvement in the operations of a farming business that meets the criteria for material participation in an activity under IRC Section 469(h) and the federal tax regulations for material participation in

26 CFR 1.469-5 and 1.469-5T for the applicable number of years required under Iowa law for the deduction, the taxpayer has met the material participation requirement. IRC Section 469(h)(3) does not apply when determining material participation for the purposes of this rule.

a. Work done in connection with an activity is not participation in the activity if the work is not of a type that is customarily done by an owner and one of the principal purposes for the performance of the work is to avoid the disallowance of any loss or credit from the activity.

b. Work done in an activity by an individual in the individual's capacity as an investor is not material participation in the business or activity unless the investor is directly involved in the day-to-day management or operations of the activity or business. Investor-type activities include the study and review of financial statements or reports on operations of the activity, preparing or compiling summaries or analyses of finances or operations of the activity for the individual's own use, and monitoring the finances or operations of the activity in a nonmanagerial capacity.

c. A highly relevant factor in material participation in a business is how regularly the taxpayer is present at the place where the principal operations of a business are conducted. In addition, a taxpayer is likely to have material participation in a business if the taxpayer performs all functions of the business. The fact that the taxpayer utilizes employees or contracts for services to perform daily functions in a business will not prevent the taxpayer from qualifying as materially participating in the business, but the services will not be attributed to the taxpayer.

d. In determining whether a particular taxpayer has material participation in a business, participation of the taxpayer's spouse in a business must also be taken into account. Activity done by a taxpayer's spouse is considered activity done by the taxpayer. The spouse's participation in the business must be taken into account even if the spouse does not file a joint state return with the taxpayer or if the spouse has no ownership interest in the business. The activities of other family members, employees, independent contractors, vendors, laborers, or consultants are not attributed to the taxpayer to determine material participation.

e. Generally, an individual will be considered as materially participating in a tax year if the taxpayer satisfies or meets any of the following tests:

(1) The individual participates in the farming business for more than 500 hours in the taxable year.

(2) The individual's participation in the farming business constitutes substantially all of the participation of all individuals in the business (including individuals who are not owners of interests in the business) for the tax year.

EXAMPLE 1: Taxpayer A is a teacher in a small town in southeast Iowa. Taxpayer A owns 20 acres of farmland. Taxpayer A grows various crops on this land and is the only one who works on the farm. In one tax year, a drought killed most of Taxpayer A's crops so Taxpayer A spent only 80 hours during that tax year growing crops. Taxpayer A is deemed to have materially participated in the farming business during that tax year.

(3) The individual participates in the farming business for more than 100 hours in the tax year, and no other individual (including individuals who are not owners of interests in the business) participates more in the business than the taxpayer during the tax year.

(4) The individual participates in two or more businesses, excluding rental businesses, in the tax year; participates for more than 500 hours in all of the businesses and more than 100 hours in each of the businesses; and the participation is not material participation within the meaning of one of the tests in subparagraphs 302.18(2) "e"(1) through "e"(3), "e"(5) and "e"(6).

EXAMPLE 2: Taxpayer B is a full-time CPA. Taxpayer B owns a restaurant and a farm. Taxpayer B spent 400 hours working on the farm and 150 hours at the restaurant during a tax year, and other individuals spent more time in the business activity than Taxpayer B did. Taxpayer B is treated as a material participant in each of the businesses during that tax year.

(5) The individual materially participated (determined without regard to this subparagraph) in a farming business for five of the ten years preceding the applicable tax year.

EXAMPLE 3: Taxpayer C is the co-owner of a farming business. Taxpayer C stopped farming in 2018 after 15 years of farming. Since Taxpayer C stopped farming, Taxpayer C has retained interest in the farming business. Taxpayer C is considered to be materially participating in the business in 2019, 2020, 2021, 2022, and 2023 because Taxpayer C materially participated in the farming business during five of the ten years immediately preceding 2019, 2020, 2021, 2022, and 2023.

(6) The individual participates in the business activity for more than 100 hours and, based on all the facts and circumstances, the individual participates on a regular, continuous, and substantial basis. Management activities of a taxpayer are not considered for purposes of determining if there was material participation if either of the following applies: any person other than the taxpayer is compensated for management services or any person provides more hours of management services than the taxpayer.

f. The following paragraphs provide additional information regarding material participation:

(1) Limited partners of a limited partnership. The limited partners will not be treated as materially participating in any activity of a limited partnership, except in a situation where the limited partner would be treated as materially participating under the material participation tests in subparagraph 302.18(2) “e”(1) or “e”(5) if the taxpayer were not a limited partner for the tax year.

(2) Cash farm lease. A taxpayer who rents out farmland on a cash basis is not materially participating in a farming business. The burden is on the taxpayer to show that the taxpayer materially participated in the farming business operated on the cash-rented farmland.

(3) Farmer landlord involved in crop-share arrangement. A farmer landlord is subject to self-employment tax on net income from a crop-share arrangement with a tenant. The landlord is considered to be materially participating with the tenant in the crop-share activity if the landlord satisfies one of the four following tests:

TEST 1: The landlord does any three of the following: (1) pays or is obligated to pay for at least half the direct costs of producing the crop; (2) furnishes at least half the tools, equipment, and livestock used in producing the crop; (3) consults with the tenant; and (4) inspects the production activities periodically.

TEST 2: The landlord regularly and frequently makes, or takes part in making, management decisions substantially contributing to or affecting the success of the enterprise.

TEST 3: The landlord worked 100 hours or more spread over a period of five weeks or more in activities connected with crop production.

TEST 4: The landlord has done tasks or performed duties that, considered in their total effect, show that the landlord was materially and significantly involved in the production of the farm commodities.

(4) Conservation reserve program (CRP). Activities conducted under the CRP do not fall within the definition of “farming business” under Iowa Code section 422.7. If a taxpayer’s only activity is managing CRP land, the taxpayer does not meet the material participation requirement. A taxpayer may still meet the material participation requirement if the taxpayer materially participates in a farming business through a different activity.

(5) Recordkeeping requirements. Taxpayers are required to provide proof of services performed and the hours attributable to those services. Detailed records should be maintained by the taxpayer, on as close to a daily basis as possible at or near the time of the performance of the activity, to verify that the material participation test has been met. However, material participation can be established by any other reasonable means, such as approximating the number of hours based on appointment books, calendars, or narrative summaries. Records prepared long after the activity, in preparation of an audit or proceeding, are insufficient to establish participation in an activity.

302.18(3) Lifetime election. A retired farmer may make a single lifetime election on a form prescribed by the department to exclude all qualifying capital gains from the sale of real property used in a farming business and the sale of certain livestock described in subrules 302.18(5) and 302.18(6). If a retired farmer makes the election described in this subrule, the retired farmer is not eligible to make the election to exclude the net income received pursuant to a farm tenancy agreement covering real property under Iowa Code section 422.7(14) and rule 701—302.19(422) or claim the beginning

farmer tax credit under Iowa Code section 422.11E in the same tax year or any subsequent tax year. The election is irrevocable once made.

a. Beginning farmer tax credit. A retired farmer shall not utilize an unclaimed amount of a beginning farmer tax credit in the same tax year the farmer is making an election described in this subrule or in subrule 302.19(3) or in any subsequent tax year.

b. Surviving spouses. A surviving spouse of a deceased retired farmer may be eligible to make the election described in this subrule or the election described in subrule 302.19(3) or exclude the qualifying income pursuant to the election made by the retired farmer prior to death.

(1) A surviving spouse of a deceased retired farmer may make the election described in this subrule or the election described in subrule 302.19(3) on behalf of the deceased retired farmer that the retired farmer would have been eligible to make prior to death. A surviving spouse may only make an election on behalf of the deceased retired farmer by the due date of the tax return, including extensions, for the tax year immediately following the tax year of the retired farmer's death.

EXAMPLE 1: Farmer A, a retired farmer, owned real property used in a farming business, Plot 1. Farmer A was married to Spouse B. Farmer A sold Plot 1, which generated a capital gain. Farmer A died later that tax year. Farmer A qualified to make an election to exclude qualifying capital gains from the calculation of net income prior to death but did not make an election before death. Spouse B can make an election on behalf of Farmer A on the final tax return.

(2) If a retired farmer made the election described in this subrule or the election described in subrule 302.19(3) prior to death, the surviving spouse of the deceased retired farmer may exclude the qualifying income pursuant to the election made by the retired farmer prior to death. A surviving spouse cannot change the election the deceased retired farmer made. Any election made by the retired farmer prior to death is binding on all real property used in a farming business owned by the retired farmer at the time of death. This election is only binding on the retired farmer and the surviving spouse.

EXAMPLE 2: Farmer C, a retired farmer, owned real property used in a farming business, Plot 2. Farmer C was married to Spouse D. Farmer C met the material participation and holding period requirements. Farmer C made the election to exclude net income from a farm tenancy agreement described in subrule 302.19(3) from Plot 2. Farmer C then died. Spouse D inherited Plot 2 from Farmer C. Spouse D does not qualify to make an election. Spouse D may exclude net income from a farm tenancy agreement from Plot 2 pursuant to the election Farmer C made before death. Spouse D cannot exclude qualifying capital gains with regard to Plot 2 or claim the beginning farmer tax credit.

EXAMPLE 3: Assume the same facts as Example 2, but Spouse D does qualify to make an election independent of Farmer C. Spouse D still cannot exclude qualifying capital gains from Plot 2 or claim the beginning farmer tax credit unless Spouse D disclaims Farmer C's election and makes an election as described in subparagraph 302.18(3) "b"(3).

EXAMPLE 4: Farmer E, a retired farmer, owned real property used in a farming business, Plot 3, Plot 4, and Plot 5. Farmer E was married to Spouse F. Farmer E met the holding period and material participation requirements. Farmer E sold Plot 3, which generated a capital gain. Farmer E made an election to exclude the capital gain. Farmer E then died. Spouse F inherited Plot 4 and Plot 5 from Farmer E. Plot 4 and Plot 5 are bound by the election Farmer E made before death. Spouse F is eligible to exclude the capital gain from the sale of Plot 4 and Plot 5 pursuant to the election Farmer E made. Spouse F cannot exclude net income from a farm tenancy agreement from Plot 4 or Plot 5 or claim the beginning farmer tax credit.

EXAMPLE 5: Farmer G, a retired farmer, owned real property used in a farming business, Plot 6 and Plot 7. Farmer G was married to Spouse H. Farmer G met the holding period and the material participation requirements. Farmer G made the election to exclude net income from a farm tenancy agreement described in subrule 302.19(3) from Plot 6 and Plot 7. Farmer G then died. Spouse H inherited Plot 6 and Plot 7. Spouse H is bound by the election made by Farmer G on Plot 6 and Plot 7 and may exclude the net income from a farm tenancy agreement for those plots. Spouse H gets remarried to a new spouse, Spouse J. Spouse H then dies. Spouse J inherits Plot 6 and Plot 7 from

Spouse H. Spouse J is not a surviving spouse of a retired farmer and is not bound by the election Farmer G originally made on Plot 6 and Plot 7. Spouse J may make an election described in this subrule or described in subrule 302.19(3) on Plot 6 and Plot 7 if Spouse J meets the eligibility criteria.

(3) A surviving spouse of a deceased retired farmer may disclaim the election made by the retired farmer. If a surviving spouse of a deceased retired farmer makes this disclaimer, the surviving spouse is not eligible to deduct qualifying income pursuant to an election made by the retired farmer prior to death. A surviving spouse of a deceased retired farmer shall make this disclaimer on a form prescribed by the department and file the form with the surviving spouse's income tax return. A surviving spouse must make the disclaimer by the due date of the tax return, including extensions, for the tax year immediately following the tax year of the retired farmer's death. If the surviving spouse excluded income on the surviving spouse's return for the tax year of the retired farmer's death pursuant to the election the retired farmer made and wants to disclaim the election, then the surviving spouse must amend the surviving spouse's return to include that income in Iowa net income and adjust tax liability accordingly. If no disclaimer is made by the due date, including extensions, of the surviving spouse's income tax return for the tax year immediately following the tax year of the retired farmer's death, then the surviving spouse is no longer eligible to make a disclaimer and is bound by the election the retired farmer made. The disclaimer is irrevocable once made. Once a disclaimer has been made, a surviving spouse may make a single lifetime election that would also apply to the land previously bound by the deceased retired farmer's election if the surviving spouse meets the definition of a retired farmer. A surviving spouse may make a single lifetime election that would apply to land not bound by the deceased retired farmer's election if the surviving spouse meets the eligibility criteria.

EXAMPLE 6: Farmer K, a retired farmer, owned real property used in a farming business, Plot 8. Farmer K was married to Spouse L. Farmer K met the holding period and the material participation requirements. Farmer K made the election to exclude net income from a farm tenancy agreement described in subrule 302.19(3) from Plot 8. Farmer K then died. Spouse L inherited Plot 8 from Farmer K. Spouse L independently qualifies as a retired farmer to make an election described in this subrule or the election described in subrule 302.19(3). Spouse L may exclude net income from a farm tenancy agreement from Plot 8 pursuant to the election Farmer K made before death, or Spouse L may disclaim that election and make Spouse L's own election to exclude capital gains from Plot 8.

EXAMPLE 7: Assume the same facts as Example 6, except Spouse L does not independently qualify as a retired farmer to make an election described in this subrule or the election described in subrule 302.19(3). Spouse L may exclude net income from a farm tenancy agreement from Plot 8 pursuant to the election Farmer K made before death, or Spouse L may disclaim that election and not exclude income because Spouse L does not qualify to make an election as a retired farmer.

c. Joint owners. A retired farmer may exclude income pursuant to the election described in this subrule or the election described in subrule 302.19(3) to the extent of the retired farmer's ownership interest in the real property.

(1) A retired farmer who owns real property used in a farming business jointly with a spouse and makes the election described in this subrule or the election described in subrule 302.19(3) may only exclude qualifying income from that real property to the extent of the retired farmer's ownership interest held in that real property. The retired farmer's ownership interest does not include the ownership interest of the retired farmer's spouse. If each spouse qualifies as a retired farmer, each spouse may make different elections on the property they jointly own to the extent of their respective ownership interests. There is a rebuttable presumption that spouses who jointly own real property used in a farming business each have a 50 percent ownership interest in the real property. This can be rebutted with documentation proving a different ownership percentage.

EXAMPLE 8: Farmer M and Farmer N, both retired farmers, are married and own Plot 9 jointly. They each have a 50 percent ownership interest in Plot 9. They both qualify to make the election to exclude qualifying capital gains or net income from a farm tenancy agreement. They file jointly for Iowa tax purposes. Farmer M and Farmer N receive \$50,000 total in net income from a farm tenancy

agreement covering Plot 9. Farmer M makes the election to exclude net income from a farm tenancy agreement. Farmer N does not make an election. Farmer M is eligible to exclude \$25,000, 50 percent of the net income from Plot 9, from net income. Farmer N must include \$25,000, 50 percent of the net income from the farm tenancy agreement, in net income. Farmer N is still eligible to make an election to exclude qualifying capital gains or net income from a farm tenancy agreement in a subsequent tax year.

EXAMPLE 9: Assume the same facts as Example 8, except Farmer N makes the same election to exclude net income from a farm tenancy agreement. On the jointly filed return, Farmer M and Farmer N can exclude from net income \$50,000, 100 percent of the net income from a farm tenancy agreement.

EXAMPLE 10: Assume the same facts as Example 8, except Farmer N does not qualify to make an election to exclude qualifying capital gains or net income from a farm tenancy agreement. Farmer M can exclude from net income \$25,000, 50 percent of the net income received from a farm tenancy agreement on Plot 9. Farmer N must include in net income \$25,000, 50 percent of the net income from the farm tenancy agreement on Plot 9.

(2) A retired farmer who owns real property used in a farming business jointly with someone who is not the retired farmer's spouse may only exclude qualifying income from that real property to the extent of the retired farmer's ownership interest held in the real property.

EXAMPLE 11: Farmer O, a retired farmer, owns Plot 10 jointly with Farmer P. Farmer O and Farmer P are not taxed as a partnership. Farmer O has a 60 percent ownership interest in Plot 10, while Farmer P has a 40 percent ownership interest. Farmer O qualifies to make an election to exclude qualifying capital gains or net income from a farm tenancy agreement. Farmer P does not. Farmer O and Farmer P sell Plot 10 for a capital gain of \$100,000. Farmer O elects to exclude the capital gain. Farmer O may exclude from net income \$60,000, 60 percent of the capital gain. Farmer P is required to include \$40,000 in net income, 40 percent of the capital gain.

302.18(4) *Net capital gains from the sale of real property used in a farming business.* Net capital gains from the sale of real property used in a farming business may be excluded from the owner's Iowa net income if the owner held the real property used in a farming business for ten or more years and materially participated in a farming business for at least ten years. If the taxpayer is a retired farmer, the taxpayer must make the election described in subrule 302.18(3) to exclude qualifying capital gains. It is not required that the property be located in Iowa for the owner to qualify for the deduction.

a. Material participation means the same as "materially participated" as defined in Iowa Code section 422.7(13) and described in detail in subrule 302.18(2). If the taxpayer is a retired farmer and materially participated in a farming business for ten or more years in the aggregate, then the taxpayer will meet the material participation requirements. If the taxpayer is not a retired farmer, the taxpayer must have materially participated in a farming business for the ten years immediately preceding the sale. When determining whether a taxpayer is no longer materially participating to meet the definition of a retired farmer, the material participation test in subparagraph 302.18(2) "e"(5) shall not apply and the participation of the spouse of the taxpayer does not count as participation by the taxpayer.

b. If the taxpayer has held the real property used in a farming business and sells the property to a relative of the taxpayer, the net capital gain from the sale may be excluded from net income regardless of whether the taxpayer met the material participation or holding period requirements.

c. In situations in which real property was sold by a partnership, S corporation, limited liability company, estate, or trust and the capital gain from the sale of the real property flows through to the owners of the business entity for federal income tax purposes, the owners may exclude the capital gain from their net incomes if the real property was held for ten or more years and the owners had materially participated in a farming business for ten years prior to the date of sale of the real property or ten years in the aggregate if the owner is a retired farmer.

d. Installments received in the tax year from installment sales of real property used in a farming business are eligible for the exclusion of capital gains from net income if all relevant criteria were met at the time of the installment sale.

EXAMPLE 1: A taxpayer received an installment payment in 2025 from the sale of real property used in a farming business that occurred in 2023. The installment received in 2025 would qualify for the exclusion if the taxpayer had held the real property for a minimum of ten years and had materially participated in a farming business for a minimum of ten years at the time of the sale in 2023.

e. Capital gains from the sale of real property by a C corporation do not qualify for the capital gain deduction.

f. The following noninclusive examples illustrate how this subrule applies:

EXAMPLE 2: S corporation, X, owned 1,000 acres of farmland. Taxpayer A is the sole shareholder of X and had materially participated in X for more than ten years at the time that X sold 500 acres of the farmland for a capital gain of \$100,000. X owned the farmland for more than ten years at the time of the sale. The capital gain recognized by X that passed through to Taxpayer A as the shareholder of X can be excluded from Iowa net income because Taxpayer A met the material participation and holding period requirements.

EXAMPLE 3: Taxpayer B and Taxpayer C are siblings who both owned 50 percent of the stock in an S corporation, Y, that owned 1,000 acres of farmland. Taxpayer B managed all the farming operations for Y from the time Y was formed. Taxpayer C did not participate in the farming operations. Y sold 200 acres of the farmland to another sibling, Taxpayer D, for a \$50,000 gain. \$25,000 of the capital gain passed through to Taxpayer B, and \$25,000 of the capital gain passed through to Taxpayer C. Both Taxpayer B and Taxpayer C had owned the corporation for at least ten years at the time the land was sold, but only Taxpayer B had materially participated in the corporation for at least ten years. Taxpayer B may exclude the \$25,000 capital gain from the land sale because Taxpayer B met the time held and material participation requirements. Taxpayer C may exclude the \$25,000 capital gain because the land was sold to a relative of Taxpayer C.

EXAMPLE 4: Taxpayer E owned and materially participated in a farming business for 15 years and raised row crops. There were 500 acres of land in the farming business, 300 acres had been held for 15 years, and 200 acres had been held for five years. Taxpayer E sold the 500 acres of land. Taxpayer E cannot exclude the capital gain from the sale of the 200 acres that had only been held for five years. Taxpayer E may exclude the capital gain from the sale of the 300 acres of land that had been held for 15 years.

EXAMPLE 5: Taxpayer F owned and materially participated in a farming business for more than ten years. In this business, Taxpayer F farmed a neighbor's land on a crop-share basis throughout the period. Taxpayer F bought 80 acres of land and farmed that land for six years until Taxpayer F sold the land for a capital gain of \$20,000. Taxpayer F cannot exclude the capital gain because the farmland had been held for less than ten years, even though Taxpayer F materially participated in a farming business for more than ten years.

EXAMPLE 6: Taxpayer G and Taxpayer H were partners in a partnership for 20 years that owned 80 acres of farmland. Taxpayer G and Taxpayer H are both over 55 years old. The land was sold when Taxpayer G and Taxpayer H retired from farming. In all the years Taxpayer G and Taxpayer H were partners in the partnership, Taxpayer G materially participated in the farming business. Taxpayer H was a material participant for the first five years and the last five years of being a partner. Taxpayer G and Taxpayer H realized a capital gain of \$50,000 from the land sale, which was divided equally between them. Taxpayer G was able to exclude \$25,000 of the capital gain that Taxpayer G received from the sale since Taxpayer G had held the land and materially participated in a farming business for at least ten years at the time the land was sold. Taxpayer H was able to exclude \$25,000 of the capital gain because, although Taxpayer H had not materially participated in a farming business for ten consecutive years when the land was sold, Taxpayer H was a retired farmer and had materially participated in a farming business for ten years in the aggregate.

EXAMPLE 7: Taxpayer J had a farming business that Taxpayer J owned and materially participated in for 20 years. There were two tracts of farmland in the farming business. Taxpayer J sold one tract of farmland in the farming business that Taxpayer J had held for more than ten years for a \$50,000 capital gain. The farmland was sold to a person who was not a relative. During the same year, Taxpayer J had \$30,000 in long-term capital losses from sales of stock. In this situation, the capital gains would not be applied against the capital losses. Because the capital losses are unrelated to the farming business, Taxpayer J does not have to reduce the Iowa capital gain deduction by the capital losses from the sales of stock.

EXAMPLE 8: Taxpayer K had owned farmland, Plot A, and had materially participated in a farming business since 2010. In 2018, Taxpayer K entered into a like-kind exchange under IRC Section 1031 for farmland, Plot B. Taxpayer K continued to materially participate in a farming business. Plot B was sold in 2023, resulting in a capital gain. Under IRC Section 1223, the holding period for the capital gain starts in 2010. Taxpayer K held Plot B for less than ten years, but because Taxpayer K met the ten-year holding period requirement under Section 1223, the capital gain from the sale qualifies for the Iowa capital gain deduction.

EXAMPLE 9: Taxpayer L and Taxpayer M, a married couple, owned farmland in Iowa since 1995. Taxpayer L died in 2010 and, under Taxpayer L's will, Taxpayer M acquired a life interest in the farm. The farmland was managed by their child, Taxpayer N, after Taxpayer L's death. Taxpayer N had a remainder interest. Taxpayer M died in 2018, and Taxpayer N continued to materially participate and manage the farm operation. Taxpayer N sold the farmland in 2023 and reported a capital gain. Under IRC Section 1223, the holding period for the capital gain started in 2010, when Taxpayer L died. Because the holding period for the capital gain was ten years or more and Taxpayer N met the material participation requirement, Taxpayer N can deduct the capital gain.

302.18(5) *Net capital gains from the sale of cattle or horses used for certain purposes and held for 24 months by taxpayers who are retired farmers.* Net capital gains from the sale of cattle or horses held for 24 months or more for draft, breeding, dairy, or sporting purposes may be excluded from the taxpayer's Iowa net income if the taxpayer is a retired farmer and the taxpayer made the election described in subrule 302.18(3). The retired farmer must have materially participated in the farming business in which the cattle or horses were held for five of the eight years preceding the retired farmer's retirement or disability and must have sold all or substantially all of the retired farmer's interest in the farming business by the time the election is made. For purposes of this subrule and subrule 302.18(6), "substantially all" means 90 percent of the interest in the farming business.

a. Material participation means the same as "materially participated" as defined in Iowa Code section 422.7(13) and described in detail in subrule 302.18(2). When determining whether a taxpayer is no longer materially participating to meet the definition of a retired farmer, the material participation test in subparagraph 302.18(2)"e"(5) shall not apply and the participation of the spouse of the taxpayer does not count as participation by the taxpayer.

b. Whether cattle or horses sold by the taxpayer after the taxpayer has held them 24 months or more were held for draft, breeding, dairy, or sporting purposes may be determined from federal court cases on such sales and the standards and examples included in 26 CFR 1.1231-2. Proper records should be kept showing purchase and birth dates of cattle and horses. The absence of records may make it impossible for the owner to show that the owner held a particular animal for the necessary holding period. Whether cattle or horses are held for draft, breeding, dairy, or sporting purposes depends on all the facts and circumstances of each case.

c. Capital gains from sales of qualifying cattle or horses by an S corporation, partnership, or limited liability company, where the capital gains flow through to the owners of the respective business entity for federal income tax purposes, qualify for the capital gain deduction to the extent the owners receiving the capital gains are retired farmers who meet all the relevant criteria.

d. Capital gains from sales of qualifying cattle or horses by a C corporation are not eligible for the capital gain deduction.

302.18(6) *Net capital gains from the sale of breeding livestock, other than cattle or horses, held for 12 or more months by taxpayers who are retired farmers.* Net capital gains from the sale of breeding livestock, other than cattle or horses, held for 12 or more months may be excluded from the taxpayer's Iowa net income if the taxpayer is a retired farmer and the taxpayer made the election described in subrule 302.18(3). The retired farmer must have materially participated in the farming business in which the breeding livestock, other than cattle or horses, were held for five of the eight years preceding the retired farmer's retirement or disability. The retired farmer must have sold all or substantially all of the retired farmer's interest in the farming business by the time the election is made.

a. Material participation means the same as "materially participated" as defined in Iowa Code section 422.7(13) and described in detail in subrule 302.18(2). When determining whether a taxpayer is no longer materially participating to meet the definition of a retired farmer, the material participation test in subparagraph 302.18(2)"e"(5) shall not apply and the participation of the spouse of the taxpayer does not count as participation by the taxpayer.

b. If livestock other than cattle or horses is considered to have been held for breeding purposes under the criteria established in 26 CFR 1.1231-2, the livestock will also be deemed to have been breeding livestock for purposes of this rule. Proper records should be kept showing purchase and birth dates of breeding livestock. The absence of records may make it impossible for the owner to show that the owner held a particular animal for the necessary holding period. Whether livestock are held for breeding purposes depends on all the facts and circumstances of each case.

c. Capital gains from sales of qualifying livestock other than cattle or horses by an S corporation, partnership, or limited liability company, where the capital gains flow through to the owners of the respective business entity for federal income tax purposes, qualify for the capital gain deduction to the extent the owners receiving the capital gains are retired farmers who meet all the relevant criteria.

d. Capital gains from the sale of breeding livestock other than cattle or horses by a C corporation are not eligible for the capital gain deduction.

302.18(7) *Net capital gains from the sale of cattle or horses used for certain purposes, or breeding livestock.* Net capital gains from the sale of cattle or horses held for 24 months or more for draft, breeding, dairy, or sporting purposes may be excluded from the taxpayer's Iowa net income if the taxpayer received more than one-half of the taxpayer's gross income from farming or ranching operations during the tax year and did not take the exclusions described in subrule 302.18(5) or 302.18(6). Net capital gains from the sale of breeding livestock, other than cattle or horses, held by the taxpayer for a period of 12 months or more may be excluded from the taxpayer's Iowa net income if the taxpayer received more than one-half of the taxpayer's gross income from farming or ranching operations during the tax year and did not take the exclusions described in subrule 302.18(5) or 302.18(6).

a. Whether cattle or horses or other breeding livestock sold by the taxpayer were held for draft, breeding, dairy, or sporting purposes may be determined from federal court cases on such sales and the standards and examples included in 26 CFR 1.1231-2. Proper records should be kept showing purchase and birth dates of the livestock. The absence of records may make it impossible for the owner to show that the owner held a particular animal for the necessary holding period. Whether cattle or horses or other livestock are held for draft, breeding, dairy, or sporting purposes depends on all the facts and circumstances of each case.

b. Capital gains from sales of qualifying cattle, horses, or livestock by an S corporation, partnership, or limited liability company, where the capital gains flow through to the owners of the respective business entity for federal income tax purposes, qualify for the capital gain deduction to the extent the owners receiving the capital gains receive one-half of their income from farming or ranching operations.

c. Capital gains from sales of qualifying cattle or horses by a C corporation are not eligible for the capital gain deduction.

d. A taxpayer's gross income from farming or ranching includes amounts the individual has received in the tax year from cultivating the soil or raising or harvesting any agricultural commodities. Gross income from farming or ranching includes the income from the operation of a stock, dairy, poultry, fish, bee, fruit, or truck farm, plantation, ranch, nursery, range, orchard, or oyster bed, as well as income in the form of crop shares received from the use of the taxpayer's land. Gross income from farming or ranching also includes total gains from sales of draft, breeding, dairy, or sporting livestock. To make the calculation as to whether more than half of the taxpayer's gross income in the tax year is from farming or ranching operations, the gross income from farming or ranching is divided by the taxpayer's total gross income. If the resulting percentage is greater than 50 percent, the taxpayer's capital gains from sales of cattle, horses, or breeding livestock will be considered for the capital gain deduction. In instances where married taxpayers file a joint return, the gross income from farming or ranching of both spouses will be considered for the purpose of determining whether the taxpayers received more than half of their gross income from farming or ranching. However, in situations where married taxpayers file separate Iowa returns, each spouse must separately determine whether that spouse has more than 50 percent of gross income from farming or ranching operations.

302.18(8) *Installments from sales consummated before January 1, 2023.* Installments from sales that were consummated before January 1, 2023, that result in net capital gains qualify for the capital gain deduction if the requirements of Iowa Code section 422.7(21) and rule 701—302.38(422), as they existed prior to January 1, 2023, were met at the time the sale was consummated.

This rule is intended to implement Iowa Code section 422.7(13).

701—302.19(422) Net income from a farm tenancy agreement covering real property. An eligible individual may elect to exclude net income from a farm tenancy agreement covering real property held by the individual for ten or more years from the computation of net income if the eligible individual materially participated in a farming business for ten or more years.

302.19(1) Definitions. Unless otherwise indicated in this rule or required by the context, all words and phrases used in this rule that are defined under Iowa Code section 422.7(14) shall have the same meaning as provided to them under that Iowa Code section.

“Disabled individual” means an individual who is receiving benefits as a result of retirement from employment or self-employment due to disability. *“Disabled individual”* includes an individual who is determined disabled in accordance with criteria established by the Social Security Administration or other federal or state governmental agency.

“Held” shall be determined with reference to the holding period provisions of IRC Section 1223 and the federal regulations pursuant thereto.

302.19(2) Material participation. Material participation for the purposes of this rule is determined pursuant to subrule 302.18(2) and the definition of “materially participated” in Iowa Code section 422.7(14). An eligible individual meets the material participation requirements if the individual materially participated in a farming business for ten years or more in the aggregate. When determining whether an eligible individual has stopped materially participating, the material participation test in subparagraph 302.18(2)“e”(5) and the material participation of a spouse shall not apply.

302.19(3) Lifetime election. An eligible individual may make a single lifetime election on a form prescribed by the department to exclude net income pursuant to a farm tenancy agreement covering real property. If an eligible individual makes the election described in this subrule, the eligible individual is not eligible to make an election to exclude the capital gain from the sale of real property used in a farming business or certain livestock under Iowa Code section 422.7(13) and rule 701—302.18(422) or claim the beginning farmer tax credit under Iowa Code section 422.11E in the same tax year or any subsequent tax year. The election is irrevocable once made.

a. *Beginning farmer tax credit.* A retired farmer shall not utilize an unclaimed amount of a beginning farmer tax credit in the same tax year the retired farmer is making an election described in this subrule or in subrule 302.18(3) or in any subsequent tax year.

b. Surviving spouses. A surviving spouse of a deceased eligible individual may make the election described in this subrule or the election described in subrule 302.18(3) subject to the provisions of subrule 302.18(3). For purposes of this subrule, “retired farmer” as used in subrule 302.18(3) has the same meaning as “eligible individual.”

c. Joint owners. An eligible individual may exclude income pursuant to the election described in this subrule or the election described in subrule 302.18(3) to the extent of the eligible individual’s ownership interest in the real property subject to the provisions of subrule 302.18(3). For purposes of this subrule, “retired farmer” as used in subrule 302.18(3) has the same meaning as “eligible individual.”

302.19(4) Amount of exclusion. An eligible individual that has made the election described in subrule 302.19(3) may exclude the amount of net income received from a farm tenancy agreement covering real property. An eligible individual may exclude net income from any qualifying farm tenancy agreement covering real property if the holding period requirements are met with respect to the real property in question, including agreements that are entered into after the single lifetime election is made. The amount of the exclusion cannot exceed the fair profits that would normally arise from a farm tenancy agreement between two parties operating at arm’s length.

This rule is intended to implement Iowa Code section 422.7(14).

701—302.20(422) Charitable contributions related to Iowa tax credits. A taxpayer who claims the school tuition organization tax credit, the charitable conservation contribution tax credit, the endow Iowa tax credit, or the farm to food donation tax credit cannot claim a deduction for charitable contributions under IRC Section 170 for the amount of the contribution related to the tax credit for Iowa tax purposes.

This rule is intended to implement Iowa Code sections 15E.305, 190B.106, 422.7, 422.11S, and 422.11W.

ITEM 2. Rescind 701—Chapter 303 and adopt the following new chapter in lieu thereof:

CHAPTER 303 IOWA-SOURCE INCOME

701—303.1(422) Income of nonresidents. Except as otherwise provided in this rule, all income of nonresidents derived from sources within Iowa is subject to Iowa income tax.

303.1(1) Included. The following are included in Iowa net income:

a. Net income received by a nonresident taxpayer from a business, trade, profession, or occupation in Iowa.

b. Income from the sale of property, located in Iowa, and any income from the property prior to its sale, including property used in connection with the trade, profession, business or occupation of the nonresident even though the sale is consummated outside of Iowa, and provided that the property was sold before subsequent use outside of Iowa.

c. Income received from a trust or an estate, where the income is from Iowa sources regardless of the situs of the estate or trust.

d. Dividends received in lieu of, or in partial or full payment of, an amount of wages or salary due for services performed in Iowa by a nonresident.

e. Annuities, interest on bank deposits and interest-bearing obligations, and dividends to the extent they are derived from a business, trade, profession, or occupation carried on within the state of Iowa by the nonresident.

f. Interest received from the sale of property, on an installment contract even though the gain from the sale of the property is subject to Iowa taxation, is not allocable to Iowa if the property is not part of the nonresident’s trade, profession, business or occupation.

303.1(2) Nonresidents exempt from paying tax. Iowa Code sections 422.5 and 422.13 provide the net income exemption amounts for nonresidents.

303.1(3) *Compensation for personal services of nonresidents.*

a. *Personal services performed within Iowa.* Compensation for personal services rendered within Iowa is included in Iowa net income. The salary or other compensation of an employee or corporate officer who performs services related to businesses located in Iowa, or has an office in Iowa, are not subject to Iowa tax if the services are performed while the taxpayer is outside of Iowa. However, the salary earned while the nonresident employee or officer is located within Iowa would be subject to Iowa tax. The Iowa taxable income of the nonresident shall include that portion of the total compensation received from the employer for personal services for the tax year that the total number of working days that the individual was employed within Iowa bears to the total number of working days within and without Iowa.

b. *Personal services performed outside of Iowa.* Compensation paid by an Iowa employer for services performed wholly outside of Iowa by a nonresident is not subject to Iowa individual income tax. However, all services performed within Iowa, either part-time or full-time, would be taxable to the nonresident and must be reported to this state.

c. *Compensation received from the United States government.* Compensation received from the United States government by a nonresident member of the armed forces is explained in rule 701—302.5(422).

d. *Commissions earned.* Income from commissions earned by a nonresident traveling salesperson, agent or other employee for services performed or sales made and whose compensation depends directly on the volume of business transacted by the nonresident will include that proportion of the compensation received that the volume of business transacted by the employee within Iowa bears to the total volume of business transacted by the employee within and without Iowa. Allowable deductions will be apportioned on the same basis. However, where separate accounting records are maintained by a nonresident or the employer of the business transacted in Iowa, then the amount of Iowa compensation can be reported based upon separate accounting.

e. *Income of performers.* Nonresident actors, singers, performers, entertainers, wrestlers, boxers, and similar performers must include the amount received for performances in Iowa in Iowa net income.

f. *Income of licensed professionals.* Nonresident attorneys, physicians, engineers, architects, and other similar professions, even though not regularly employed in this state, must include the amount of fees or compensation received for services performed in Iowa in Iowa net income.

g. *Services performed in intervals throughout the year.* If nonresidents are employed in Iowa at intervals throughout the year, as would be the case if employed in operating trains, planes, motor buses, or trucks and similar modes of transportation, between Iowa and other states and foreign countries, and who are paid on a daily, weekly or monthly basis, the gross income from sources within Iowa is that portion of the total compensation for personal services that the total number of working days employed within Iowa bears to the total number of working days both within and without Iowa. If paid on a mileage basis, the gross income from sources within Iowa is that portion of the total compensation for services that the number of miles traveled in Iowa bears to the total number of miles traveled both within and without Iowa. If paid on some other basis, the total compensation for personal services must be apportioned between Iowa and other states and foreign countries in such a manner as to allocate to Iowa that portion of the total compensation that is reasonably attributable to personal services performed in Iowa. Any alternative method of allocation is subject to review and change by the director. However, pursuant to federal law, nonresidents who earn compensation in Iowa and one or more other states for a railway company, an airline company, a merchant marine company, or a motor carrier are only subject to the income tax laws of their state of residence, and the compensation would not be considered gross income from sources within Iowa.

303.1(4) *Income from business sources within and without Iowa.* When a nonresident's income is derived from any business, trade, profession, or occupation carried on partly within and partly without Iowa, only such income as is fairly and equitably attributable to that portion of the business,

trade, profession, or occupation carried on in Iowa, or to services rendered within Iowa is subject to Iowa individual income tax.

303.1(5) *Apportionment of business income from business carried on both within and without Iowa.*

a. If a nonresident, or a partnership or trust with a nonresident member, transacts business both within and without Iowa, the net income must be so apportioned as to allocate to Iowa a portion of the income on a fair and equitable basis, in accordance with approved methods of accounting.

b. The amount of net income attributable to the manufacture or sale of tangible personal property shall be that portion that the gross sales made within Iowa bears to the total gross sales. The gross sales of tangible personal property are in Iowa if the property is delivered or shipped to a purchaser within Iowa, regardless of the F.O.B. point or other conditions of the sale.

c. Income derived from business other than the manufacture or sale of tangible personal property shall be attributed to Iowa in that portion that the Iowa gross receipts bear to the total gross receipts. Gross receipts are attributable to Iowa in the portion that the recipient of the service receives the benefit of the service in Iowa.

d. If the taxpayer believes that the gross sales or gross receipts methods subjects the taxpayer to taxation on a greater portion of net income than is reasonably attributable to the business within Iowa, the taxpayer may request the use of separate accounting or another alternative method that the taxpayer believes to be proper under the circumstances. In any event, the entire income received by the taxpayer and the basis for a special method of allocation shall be disclosed in the taxpayer's return and is subject to the department's approval.

e. Disaster and emergency-related work. 701—Chapter 276 provides information about allocation and apportionment of net income to Iowa by an out-of-state business or out-of-state employee who enters Iowa to perform disaster and emergency-related work during a disaster response period as those terms are defined in Iowa Code section 29C.24.

303.1(6) *Income from intangible personal property.* Business income of nonresidents from rentals or royalties for the use of or the privilege of using in Iowa, patents, copyrights, secret processes and formulas, goodwill, trademarks, franchises, and other like property is income from sources within Iowa.

a. Income of nonresidents from intangible personal property such as shares of stock in corporations, bonds, notes, bank deposits and other indebtedness is not taxable as income from sources within Iowa, except where such income is derived from a business, trade, profession, or occupation carried on within Iowa by the nonresident. If a nonresident buys or sells stocks, bonds, or other such property so regularly, systematically and continuously as to constitute doing business in Iowa, the profit or gain derived from such activity is taxable as income from a business carried on within Iowa.

b. Income of a nonresident beneficiary from an estate or trust, distributed or distributable to the beneficiary out of income from intangible personal property of the estate or trust, is not income from sources in Iowa and is not taxable to the nonresident beneficiary unless the property is so used by the estate or trust as to create a business, trade, profession, or occupation in Iowa. Whether the executor or administrator of an estate or the trustee of a trust is a resident of this state is immaterial, insofar as the taxation of income of beneficiaries from the estate or trust are concerned.

c. Following are examples to illustrate when intangible income may be subject to the allocation provisions of Iowa Code section 422.8:

EXAMPLE 1: An Illinois resident is a laborer at a factory in Davenport, Iowa. A \$50 payroll deduction is made each week from the laborer's paycheck to the company's credit union. The Illinois resident will earn \$600 in interest income from the Iowa credit union account. The interest income would not be included in the net income allocated to Iowa since the interest income is not derived from the taxpayer's business or utilized for business purposes.

EXAMPLE 2: A Nebraska resident is a self-employed plumber who has a plumbing business in Council Bluffs, Iowa. The plumber has an interest-bearing checking account in an Iowa bank that the

plumber uses to pay bills for the plumbing business. The plumber will earn \$200 in interest income from the checking account. The interest income earned by this nonresident would be taxable to Iowa since it is derived from the business and is utilized in the business.

EXAMPLE 3: An Illinois resident has a farm in Illinois. The Illinois resident has an account in an Iowa bank and invests earnings from the Illinois farm in the Iowa account. The Illinois farmer will earn \$1,000 in interest income from the account. The interest income is not included in the net income allocable to Iowa since the interest income is not derived from the taxpayer's trade or business.

EXAMPLE 4: An Illinois resident has Iowa farms. The Illinois resident invests the profits from the farms in a savings account in an Iowa bank. Several times a year, the taxpayer transfers part of the funds from the savings account to the taxpayer's checking account to purchase machinery to be used in the farming operations. The interest income would not be included in income allocated to Iowa since the interest income is not derived from the taxpayer's trade or business nor is the savings account utilized as a business account.

EXAMPLE 5: An Illinois resident is a physician and has a practice in Iowa. The physician has a business checking account in an Iowa bank that is used to pay the bills relating to the physician's practice. In the same bank, the physician has a personal savings account where all the physician's receipts for a given month are deposited. On the first working day of the month, funds are transferred from the savings account to the checking account to pay the bills that have accrued during the month. The interest income from the savings account would be included in net income allocated to Iowa since it is derived from and utilized in the business.

EXAMPLE 6: An Illinois resident has a farm in Iowa, and that is the taxpayer's principal business. The nonresident has an interest-bearing checking account in an Iowa bank. This checking account is used to pay personal expenditures as well as to pay expenses incurred in operation of the farm. The taxpayer will earn \$550 in interest from the checking account. The interest would be included in net income allocated to Iowa since the interest is derived from the business, generated from a business account, and utilized in the business.

303.1(7) *Distributive shares of nonresident partners.* When a partnership derives income from sources within Iowa, the nonresident members of the partnership are taxable only upon that portion of their distributive share of the partnership income that is derived from sources within this state.

303.1(8) *Interest and dividends from government securities of nonresidents.* Interest and dividends from securities and from securities of state and other political subdivisions exempt for federal income tax under the Internal Revenue Code are to be included in the Iowa net income of a nonresident to the extent that same are derived from a business, trade, profession, or occupation carried on within the state of Iowa by the nonresident.

303.1(9) *Gains or losses from sales or exchanges of real property and tangible personal property by a nonresident of Iowa.*

a. If a nonresident realizes any gains or losses from sales or exchanges of real property or tangible personal property within Iowa, such gains or losses are subject to the Iowa income tax. Gains or losses attributable to Iowa will be determined as follows:

(1) Gains or losses from sales or exchanges of real property located in Iowa are allocable to Iowa.

(2) Capital gains and losses from sales or exchanges of tangible personal property are allocable to Iowa if the property had a situs in Iowa at the time of the sale.

b. In determining whether a short-term or long-term capital gain or a capital loss is involved in a sale or exchange, and determining the amount of a gain from the sale of real or tangible property in Iowa, the provisions of the Internal Revenue Code are to be followed.

303.1(10) *Capital gains or losses from sales or exchanges of ownership interests in Iowa business entities by nonresidents of Iowa.* Nonresidents of Iowa who sell or exchange ownership interests in various Iowa business entities will be subject to Iowa income tax on capital gains and capital losses from those transactions for different entities as described in the following paragraphs.

a. *Capital gains from sales or exchanges of stock in C corporations and S corporations.* The sale or exchange of stock in a C corporation or an S corporation is the sale or exchange of intangible property. The capital gain received by a nonresident of Iowa from the sale or exchange of capital stock of a C corporation or an S corporation is taxable to the state of the personal domicile or residence of the owner of the capital stock unless the stock attains an independent business situs apart from the personal domicile of the individual who sold the capital stock. The stock may acquire an independent business situs in Iowa if the stock had been used as an integral part of some business activity occurring in Iowa in the year in which the sale or exchange of the stock had taken place. Whether the stock has attained an independent business status is determined on a factual basis.

EXAMPLE: A nonresident owns capital stock that was used as collateral to secure a loan to remodel a retail store in Iowa. Regardless of the ownership of the store, the stock would be considered as being used as an integral part of some business activity in Iowa. The amount of gain from the sale or exchange of stock is computed on the basis of the Iowa allocation and apportionment rules applicable to the separate business the stock has become an integral part of for the year in which the sale or exchange occurred. For example, if the business were subject to Iowa income tax on 40 percent of its income in the year of the sale or exchange, then 40 percent of the capital gain would be attributable or taxable by Iowa.

The fact that the gain from the sale or exchange of stock is taxable or partially taxable to Iowa does not mean that the dividends received by the nonresident in the year of sale are taxable to Iowa. Dividends from stock used in an Iowa specific business activity would not be taxable to Iowa, except under special circumstances. An illustration of these special circumstances would be when the dividends are from capital stock from a business where the purchase and sale of stock constitute a regular business in Iowa. In this situation, the dividends would be taxable to Iowa. Subrule 303.1(6) contains more information.

b. *Capital gains from sales or exchanges of interests in partnerships.* When a nonresident of Iowa sells or exchanges the individual's interest in a partnership, the nonresident is actually selling an intangible since the partnership can continue without the nonresident partner and the assets used by the partnership are legally owned by the partnership and an individual retains only an equitable interest in the assets of the partnership by virtue of the partner's ownership interest in the partnership. However, because of the unique attributes of partnerships, the owner's interest in a partnership is considered to be localized or sourced at the situs of the partnership's activities as a matter of law. Therefore, if a partnership conducts all of its business in Iowa, 100 percent of the gain on the sale or exchange of a partnership interest would be attributable to Iowa. On the other hand, if the partnership conducts 100 percent of its business outside of Iowa, none of the gain would be attributable to Iowa for purposes of the Iowa income tax. In the situation where a partnership conducts business both in and out of Iowa, the capital gain from the sale or exchange of an interest in the partnership would be allocated or apportioned in and out of Iowa based upon the partnership's activities in and out of Iowa in the year of the sale or exchange.

Note that if a partnership is a publicly traded partnership and is taxed as a corporation for federal income tax purposes, any capital gains realized on the sale or exchange of a nonresident partner's interest in the partnership will receive the same tax treatment as the capital gain from the sale or exchange of an interest in a C corporation or an S corporation as specified in paragraph 303.1(10) "a."

c. *Capital gains from sales or exchanges of sole proprietorships.* When a nonresident sells or exchanges the individual's interest in a sole proprietorship, the nonresident is actually selling or exchanging tangible and intangible personal property used in this business because the sole proprietor is the legal and equitable owner of all such assets. Therefore, the general source or situs rules governing the gain from the sale or exchange of tangible property and intangible property by a nonresident individual control. Thus, if the sole proprietorship is located in Iowa, the gain from the sale or exchange of the sole proprietorship by a nonresident would be taxable to Iowa.

d. *Capital gains from sales or exchanges of interests in limited liability companies.* Limited liability companies are hybrid business entities containing elements of both a partnership and a

corporation. If a limited liability company properly elected to file or would have been required to file a federal partnership tax return, a capital gain from the sale or exchange of an ownership interest in the limited liability company by a nonresident member of the company would be taxable to Iowa to the same extent as if the individual were selling a similar interest in a partnership as described in paragraph 303.1(10)“b.” However, if the limited liability company properly elected or would have been required to file a federal corporation tax return, a nonresident member who sells or exchanges an ownership interest in the limited liability company would be treated the same as if the nonresident were selling a similar interest in a C corporation or an S corporation as described in paragraph 303.1(10)“a.”

e. Taxation of corporate liquidations. As a matter of Iowa law, the proceeds from corporate liquidating distributions are not considered to be the proceeds from the sale or exchange of corporate stock. Rather, such proceeds represent the transfer back to the shareholder of that shareholder’s pro rata share of the actual assets of the corporation in which each shareholder held only an equitable ownership interest prior to the dissolution. The amount of such gain is calculated by subtracting the distribution realized from the shareholder’s basis in the stock. Thus, any gain realized by the shareholder upon such distribution is considered a capital gain from a sale or exchange of the assets by the shareholder for purposes of sourcing the shareholder’s liquidating distribution gain. Consequently, the gain, whether it is from a distribution of cash or other property, is controlled by the general source or situs rules in subrule 303.1(9) governing the taxation of the sale or exchange of tangible personal property by a nonresident and subrule 303.1(11) governing the sale or exchange of intangible personal property by a nonresident.

f. Capital losses realized by a nonresident of Iowa from the sale or exchange of an ownership interest in an Iowa business entity. In a situation where a nonresident of Iowa sells the ownership interest in an Iowa business entity and has a capital loss from the transaction, the nonresident can claim the loss on the Iowa income tax return under the same circumstances that a capital gain would have been reported as described in paragraphs 303.1(10)“a” through “e.”

303.1(11) *Capital gains and losses from sales or exchanges of intangible personal property other than ownership interests in business entities.* Capital gains and losses realized by a nonresident of Iowa from the sale or exchange of intangible personal property (other than interests in business entities) are taxable to Iowa if the intangible property was an integral part of some business activity occurring regularly in Iowa prior to the sale or exchange. In the case of an intangible asset that was an integral part of a business activity of a business entity occurring regularly within and without Iowa, a capital gain or loss from the sale or exchange of the intangible asset by a nonresident of Iowa would be reported to Iowa in the ratio of the Iowa business activity to the total business activity for the year of the sale.

This rule is intended to implement Iowa Code sections 422.5, 422.7, and 422.8.

701—303.2(422) Income of part-year residents. A taxpayer who was a resident of Iowa for only a portion of the taxable year is subject to the following rules of taxation:

303.2(1) For that portion of the taxable year for which the taxpayer was a nonresident, the taxpayer is subject to Iowa income tax only on the income derived from sources within Iowa.

303.2(2) For that portion of the taxable year for which the taxpayer was an Iowa resident, the taxpayer is subject to Iowa income tax on all income earned or received whether from sources within or without Iowa.

This rule is intended to implement Iowa Code sections 422.5, 422.7, and 422.8.

701—303.3(99E) Lottery prizes. Individuals who win Iowa lottery prizes are subject to Iowa income tax on the aggregate amount of prizes received in the tax year, even if the individuals were not residents of Iowa at the time they received the prizes.

This rule is intended to implement Iowa Code section 99G.31.

701—303.4(422) Contract sales. Interest derived as income from a land contract is intangible personal property and is assignable to the recipient's domicile. Gains received from the sale or assignment of land contracts are considered to be gains from real property in this state and are assignable to this state. Rule 701—303.16(422) provides more information for nonresidents.

This rule is intended to implement Iowa Code sections 422.7 and 422.8.

701—303.5(422) Exemption for distributions from pensions, annuities, individual retirement accounts, or deferred compensation plans received by nonresidents. A distribution from a pension plan, annuity, individual retirement account, or deferred compensation plan that is received by a nonresident of Iowa is exempt from Iowa income tax. Distributions of nonqualified retirement benefits that are paid by a partnership to its retired partners and that are received by a nonresident of Iowa are exempt from Iowa income tax to the extent the distribution is directly related to the documented retirement of the partner.

303.5(1) Distributions received by beneficiaries. Any distribution from the pension, annuity, individual retirement account, or deferred compensation arrangement will not be taxable to the beneficiary receiving the distributions if the beneficiary is a nonresident.

303.5(2) Definitions.

“Beneficiary” means an individual who receives a distribution from a pension or annuity plan, individual retirement arrangement, or deferred compensation plan as a result of either the death or divorce of the pensioner, annuitant, participant of a deferred compensation arrangement, or owner of an individual retirement account.

“Documented retirement” means any evidence that the individual can provide to the department that would establish that the individual or the individual's beneficiary is receiving distributions from the pension, annuity, individual retirement account, or deferred compensation arrangement due to the retirement of the individual.

Examples of documents that would establish an individual's retirement may include the following: copies of birth certificates or driver's licenses to establish an individual's age, copies of excerpts from an employer's personnel manual or letter from employer to establish retirement or early retirement policies, and a copy of a statement from a physician to establish an individual's disability that could have contributed to a person's retirement.

303.5(3) Examples.

a. A taxpayer worked for the same Iowa employer for 32 years and then retired and moved to Arkansas. The taxpayer started receiving distributions from the pension plan from the former employer after the move to Arkansas. These distributions would not be subject to Iowa income tax because the taxpayer is a nonresident.

b. Taxpayer A was the child of Taxpayer B who died after 25 years of employment with a company in Iowa. Taxpayer A was the sole beneficiary of Taxpayer B and started receiving distributions from Taxpayer B's pension. Taxpayer A was a resident of California while receiving distributions from Taxpayer B's pension. Taxpayer A is not subject to Iowa income tax on the distributions due to being a nonresident of Iowa at the time the distributions were received.

This rule is intended to implement Iowa Code section 422.8.

701—303.6(422) Taxation of compensation of nonresident members of professional athletic teams. The Iowa source income of a nonresident individual who is a member of a professional athletic team includes the portion of the individual's total compensation for services provided for the athletic team that is in the ratio that the number of duty days spent in Iowa rendering services for the team during the tax year bears to the total number of duty days spent both within and without Iowa in the tax year.

303.6(1) Definitions.

“Duty days,” except as provided in numbered paragraphs “4” and “5” of this definition, means all days during the taxable year from the beginning of the professional athletic team's official preseason training period through the last game in which the team competes or is scheduled to compete. Duty

days are included in the allocation described in this rule for the tax year in which they occur, including where a team's official preseason training period through the last game in which the team competes, or is scheduled to compete, occurs during more than one tax year.

1. "Duty days" includes days on which a member of a professional athletic team renders a service for a team on a date that does not fall within the previously mentioned period (e.g., participation in instructional leagues, the "Pro Bowl" or promotional caravans). Rendering a service includes conducting training and rehabilitation activities but only if conducted at the facilities of the team.

2. "Duty days" also includes game days, practice days, days spent at team meetings, promotional caravans and preseason training camps, and days served with the team through all postseason games in which the team competes or is scheduled to compete.

3. Duty days for any person who joins a team during the period from the beginning of the professional athletic team's official preseason training period through the last game in which the team competes, or is scheduled to compete, begins on the day the person joins the team. Conversely, duty days for any person who leaves a team during such period ends on the day the person leaves the team. When a person switches teams during a taxable year, separate duty day calculations are to be made for the period the person was with each team.

4. Days for which a member of a professional athletic team is not compensated and is not rendering services for the team in any manner, including days when the member of a professional athletic team has been suspended without pay and prohibited from performing any services for the team, are not to be treated as duty days.

5. Days for which a member of a professional athletic team is on the disabled list and does not conduct rehabilitation activities at facilities of the team and is not otherwise rendering services for the team in Iowa are not to be considered duty days spent in Iowa. However, all days on the disability list are considered to be included in total duty days spent both within and without Iowa.

6. Total duty days for members of a professional athletic team that are not professional athletes are the number of days in the year that the members are employed by the professional athletic team. Thus, in the case of a coach of a professional athletic team who was coach for the entire year, the coach's total duty days would be 365 for the year.

7. Travel days in Iowa by a team member that do not involve a game, practice, team meeting, all-star game, or other personal service for the team are not considered to be duty days in Iowa. However, to the extent these days fall within the period from the team's preseason training period through the team's final game, these Iowa travel days will be considered in the total duty days spent within and outside Iowa for team members who are professional athletes.

8. Duty days in Iowa do not include days a team member performs personal services for the professional athletic team in Iowa on those days that the team member is a bona fide resident of a state with which Iowa has a reciprocal tax agreement. Rule 701—300.7(422) contains more information on reciprocal tax agreements.

"Member of a professional athletic team" includes those employees who are active players, players on the disabled list, and any other persons required to travel and who travel with and perform services on behalf of a professional athletic team on a regular basis. This includes but is not limited to coaches, managers, and trainers.

"Professional athletic team" includes but is not limited to any professional baseball, basketball, football, soccer, or hockey team.

"Total compensation for services rendered as a member of a professional athletic team" means the total compensation received during the taxable year for services rendered. "Total compensation" includes but is not limited to salaries, wages, bonuses (as described in numbered paragraph "1" of this definition), and any other type of compensation paid during the taxable year to a member of a professional athletic team for services performed in that year. Such compensation does not include strike benefits, severance pay, termination pay, contract or option year buy-out payments, expansion or relocation payments, and any other payments not related to services rendered for the team.

For purposes of this definition, “bonuses” included in “total compensation for services rendered as a member of a professional athletic team” subject to the allocation described in this rule are:

1. Bonuses earned as a result of play (i.e., performance bonuses) during the season, including bonuses paid for championship, playoff, or “bowl” games played by a team, or for the member’s selection to all-star, league, or other honorary positions; and

2. Bonuses paid for signing a contract unless all of the following conditions are met:

- The payment of the signing bonus is not conditional upon the signee playing any games for the team, performing any subsequent services for the team, or making the team;
- The signing bonus is payable separately from the salary and any other compensation; and
- The signing bonus is nonrefundable.

303.6(2) *Examples of taxation of nonresident members of professional athletic teams.*

a. Player A, a member of a professional athletic team, is a nonresident of Iowa. Player A’s contract for the team requires A to report to such team’s training camp and to participate in all exhibition, regular season, and playoff games. Player A has a contract that covers seasons that occur during year one/year two and during year two/year three. Player A’s contract provides that A is to receive \$500,000 for the year one/year two season and \$600,000 for the year two/year three season. Assuming player A receives \$550,000 from the contract during taxable year two (\$250,000 for one-half the year one/year two season and \$300,000 for one-half the year two/year three season), the portion of compensation received by player A for taxable year two, attributable to Iowa, is determined by multiplying the compensation player A receives during the taxable year (\$550,000) by a fraction, the numerator of which is the total number of duty days player A spends rendering services for the team in Iowa during taxable year two (attributable to both the year one/year two season and the year two/year three season) and the denominator of which is the total number of player A’s duty days spent both within and without Iowa for the entire taxable year.

b. Player B, a member of a professional athletic team, is a nonresident of Iowa. During the season, B is injured and is unable to render services for B’s team. While B is undergoing medical treatment at a clinic, which is not a facility of the team but is located in Iowa, B’s team travels to Iowa for a game. The number of days B’s team spends in Iowa for practice, games, and meetings while B is present at the clinic are not to be considered duty days spent in Iowa for player B for that taxable year for purposes of this rule, but these days are considered to be included within total duty days spent both within and without Iowa.

c. Player C, a member of a professional athletic team, is a nonresident of Iowa. During the season, C is injured and is unable to render services for C’s team. C performs rehabilitation exercises at the facilities of C’s team in Iowa as well as at personal facilities in Iowa. The days C performs rehabilitation exercise in the facilities of C’s team are considered duty days spent in Iowa for player C for that taxable year for purposes of this rule. However, days player C spends at personal facilities in Iowa are not to be considered duty days spent in Iowa for player C for that taxable year for purposes of this rule, but the days are considered to be included within total duty days spent both within and without Iowa.

d. Player D, a member of a professional athletic team, is a nonresident of Iowa. During the season, D travels to Iowa to participate in the annual all-star game as a representative of D’s team. The number of days D spends in Iowa for practice, the game, and meetings are considered to be duty days spent in Iowa for player D for that taxable year for purposes of this rule, as well as included within total duty days spent both within and without Iowa.

e. Assume the same facts as given in paragraph 303.6(2) “d,” except that player D is not participating in the all-star game and is not rendering services for D’s team in any manner. Player D is instead traveling to and attending this game solely as a spectator. The number of days player D spends in Iowa for the game is not to be considered to be duty days spent in Iowa for purposes of this rule. However, the days are considered to be included within total duty days spent both within and without Iowa.

303.6(3) *Use of an alternative method to compute taxable portion of a nonresident's compensation as a member of a professional athletic team.* If a nonresident member of a professional athletic team believes that the method provided in this rule for allocation of the member's compensation to Iowa is not equitable, the nonresident member may request to use an alternative method for the allocation of the compensation to Iowa. This request shall be made in substantially the same manner as described in rule 701—503.9(422).

This rule is intended to implement Iowa Code sections 422.3, 422.7, and 422.8.